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ESTIMATED REVENUE POTENTIAL FROM A GENERAL SALES AND USE TAX 1990 and 1991

REVENUE OVERSIGHT COMMITTEE

December 1988

Montana Legislative Council

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ESTIMATED REVENUE POTENTIAL FROM A GENERAL SALES AND USE TAX IN MONTANA

1990 AND 1991

A REPORT TO THE 51ST LEGISLATURE
from the
REVENUE OVERSIGHT COMMITTEE

Prepared by
Jeff Martin
Staff Researcher

September 1988

Published by

Montana Legislative Council

Room 138
State Capitol
Helena, Montana 59620
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INTRODUCTION

Montana is one of the few remaining states that does not impose a retail sales tax. Only four other states do not have a general sales tax: Alaska, Delaware, New Hampshire, and Oregon. In 1985, Oregon attempted to institute a sales tax, but the measure was defeated at the polls by a margin of nearly four to one (State Legislatures, November-December 1985). The measure was again defeated in 1986 by about the same margin (Oregon Secretary of State, Blue Book, Eugene, Oregon, 1988).

During the 1987 legislative session, Montana considered a number of sales tax proposals. One, House Bill No. 377, had some bipartisan support but was ultimately rejected. Most recently, the results of the 1988 state primary election have convinced many political observers that the sales tax is, at least for now, a dead issue in Montana.

Revenue constraints and expenditure requirements, however, both at the state and local level, may cause the 1989 Legislature to consider the sales tax as an option to supplement general fund revenues or to provide property tax relief, or both.

The purpose of this report is to describe the tax base that would be associated with a general retail sales tax and to evaluate the revenue potential from such a tax. Information is presented by industrial sector in accordance with the Standard Industrial Classification system, which is a taxonomic description of the economic organization within the state.

The first section of this report discusses the classification system in order to establish the framework by which estimates of gross sales and taxable sales may be made.

An awareness of the economic organization in the state is important to the understanding that a sales tax, whether broadly or narrowly based, applies to virtually every sector in the economy because a "retail sale" can be any sale in which the buyer does not intend to resell the item (or service) purchased. This perspective shows the source of sales tax revenue.

The second section analyzes the tax base and provides estimates of potential revenue by economic sector for calendar years 1990 and 1991. The order in which each sector is presented depends on the maximum contribution to tax revenue that the sector might provide. Retail trade is the largest component in any sales tax structure and is discussed first, while agriculture and government are the least significant and are presented last.

Where applicable, alternative estimates are presented to account for some different assumptions (i.e., whether it is a broad-based or narrow-based tax) about the taxability of goods and services. In some cases, particularly mining and manufacturing, only one estimate is provided. Also included is a discussion of the limitations of the estimates by sector.

The final section presents a summary of the potential revenue from a 1 percent sales tax based on the information developed in the previous section. Separate estimates will be shown for: (1) a broad-based tax that includes most goods and services; (2) a narrow-based tax that primarily taxes goods (exempting such items as food and prescription drugs) but that also includes some services; and (3) a variation of the Senate version of House Bill No. 377 (1987).

STANDARD INDUSTRIAL CLASSIFICATION SYSTEM

Establishments are classified into industries on the basis of their principal product or activity (determined by annual sales volume) in accordance with the Standard Industrial Classification Manual. This manual is developed by the U.S. Office of Management and Budget in cooperation with other governmental agencies and industry experts.*

The Standard Industrial Classification system encompasses the national economy and provides data on a division and industry code basis, according to the level of industrial detail. This classification system is also applicable at the state level.

The economy is divided into 10 major sectors. These sectors are:

Agriculture

Mining

Contract Construction

Manufacturing

Transportation, Communications, & Public Utilities

Wholesale Trade

---

*Revisions are made when significant changes in industrial composition occur. The latest revision was for 1987, but the information presented in this report uses the 1972 classification system because most of the available data is tied to the 1972 system.

Retail Trade

Finance, Insurance, and Real Estate

Services

Government - Federal, State, Local

Each of these sectors can be broken down into major groups that may be further divided into subgroups. It is with the major groupings that the Standard Industrial Classification (SIC) codes begin. For example, food and kindred products (SIC code 20) is one of the major groups of the manufacturing sector. One of the ways this group is further divided is into meat products (SIC code 201) and meat packing plants (SIC code 2011).

SIC codes are assigned to each group and subgroup. These numbers indicate the level of detail associated with each group.

The following illustrates how each industrial division may be further defined by group or subgroup.

Agricultural
  07 Agricultural services
    074 Veterinary services

Mining
  10 Metal mining

Contract construction
  15 General contractors

Manufacturing
  24 Lumber and wood products
    242 Saw mills and planing mills

Transportation, communications, and public utilities
  49 Electric, gas, and sanitary services

Wholesale trade
  50 Wholesale trade durable goods
    551 Motor vehicles and automotive equipment

Retail trade
  55 Automobile dealers and service stations
    551 New and used car dealers

Finance, Insurance, and Real Estate
  60 Banking
    602 Commercial and stock savings banks

Services
  73 Business services (2-digit SIC code)
    739 Miscellaneous business services (3-digit SIC code)
      7392 Management and public relations (4-digit SIC code)

Government
    91 Federal
    92 State
    93 Local

As shown under the services sector, a convenient way to express the level of detail of a particular industry is by a two-, three-, or four-digit SIC code.

The purpose of the above illustration is to focus attention on the fact that a general sales tax, while usually concentrated in three or four major divisions, may actually encompass every industrial sector within a state's economy.

Table 1 shows the relative contribution of each sector to sales tax collections in five states: Idaho, New Mexico, North Dakota, Washington, and Wyoming. The information is presented by major division (or industrial sector) because of differences in reporting methods. For example, Idaho reports sales tax collections by division to the three-digit level; Washington reports collections in retail trade at the three-digit level but in much less detail for other industries; New Mexico reports all collections at the two-digit level; North Dakota and Wyoming generally show collections by major division.

Retail trade is the largest component of the sales tax in all five states, but to varying degrees. Retail trade in Idaho, which has a narrow-based tax, accounts for around 70 percent of total collections. Because groceries are taxed in Idaho, food stores make up approximately 20 percent of collections. New Mexico, which also taxes food, receives about 10 percent from food stores.

The services sector is generally the next major contributor. (However, in Washington services are slightly less important than either contract construction or wholesale trade, and in North Dakota wholesale trade is more than twice as important as services.) Other than retail trade and services, there are no general similarities by sector between states for tax collections.

TABLE 1

Percentage of Sales Tax Collections by Industrial Sector in Selected States--Fiscal Year 1987

	Idaho*	New Mexico	North Dakota**	Wash- ington	Wyoming***
Agriculture	0.4	0.3	NA	NA	0.3
Mining	0.2	3.6	1.2	NA	5.3
Contract Construction	2.7	11.5	3.3	13.6	3.2
Manufacturing	5.4	2.6	5.0	3.6	3.5
Transportation, Communications, & Public Utilities	1.3	11.4	7.5	4.1	11.5
Wholesale Trade	4.6	5.2	20.1	13.2	8.8
Retail Trade	70.7	37.1	53.9	51.5	55.8
Food Stores	19.0	10.0	NA	7.1	12.2
Finance, Insurance, & Real Estate	0.7	2.6	NA	1.3	0.5
Services	11.5	24.8	8.5	11.9	11.1
Government	2.5	0.7	NA	NA	NA
Federal	---	---	---	---	---
State	0.1	0.1	---	---	---
Local	2.3	0.6	---	---	---
Other	---	---	0.5	0.8	---
Total Collections FY 1987 (in millions of dollars)	$297.9	$699.6	$193.8	$3284.0	$150.5

* Includes use tax for percentage distribution and total collections
** 1985-1987 Biennium for percentage distribution
*** Includes use tax for percentage distribution

NA: Not available

Source: Percentage distribution: unpublished state sales tax reports
Total Collections: U.S. Bureau of Census, State Government Finances in 1987, 1988.

Note: Percentage detail may not add to 100 percent due to rounding.

TAX BASE AND REVENUE ESTIMATES

This section of the report describes the sales tax base for each of the industrial sectors listed above and evaluates the revenue potential from various assumptions about the sales that are taxed. The estimates are presented for calendar years 1990 and 1991.

A wide variety of techniques were required to make estimates of gross receipts by industrial sector. Generally, 1982 economic census data provided the information to establish the base year from which projections were made for retail and wholesale trade, services, mining, manufacturing, and contract construction. Disposable personal income, sector wages and salaries, and product prices were variously used to estimate changes in gross receipts. In addition, information from "comparison" states played a crucial role in most of the estimates.

Data for the transportation, communications, and public utilities sector and for the finance, insurance, and real estate sector were obtained from a number of sources. These sources are noted in the text.

A discussion of the methodology used for each sector is kept to a minimum except to relate what factors drive changes in gross receipts and which comparison states are used. However, the report does describe in some detail the procedures used to develop the estimates of gross receipts in the sectors of retail trade and the service industries.

Because these two sectors account for a large portion of the tax base and because they have been the focus of much of the discussion regarding the sales tax, an understanding of the derivation of the estimates for each of these sectors is important. In addition, either the procedure used to derive the estimates of retail trade or the procedure used to derive the estimates of the service industries proved useful for developing the estimates of gross receipts for other (but not all) sectors. Therefore, discussion of these two procedures precludes the need to review them for the other sectors.

With respect to the validity of the estimates, the reader should keep in mind the following:

> The estimation and projection of sales tax revenue where no previous history of a sales tax base exists depends on the use of fragmented, frequently outdated and imprecise information. This information, gathered from diverse sources, can only be used to construct a partial picture of existing [and future] conditions. Researchers are forced to complement this partial view with their own assumptions which, by definition, are likely to widen the margins of error endemic to data collection exercises. Assumptions based on past data decrease in validity at an accelerated rate as the time intervals expand.
>
> In addition, industrial data collected at different levels do not correspond to industrial or sectoral definitions required by a tax system. This is primarily due to legal definitions of that system which may be in marked contrast with the scope and objective of economic statistics.[1]

RETAIL TRADE

Retail trade is typically the most significant component of a sales tax base. Retail trade industries include establishments that are primarily engaged in selling merchandise for personal consumption, but that render some services as well. The business groups in retail trade include:

SIC Code	Kind of Business
52	Building materials
53	General merchandise
54	Food stores
55	Automotive dealers
554	Gasoline service stations
56	Apparel and accessory stores
57	Furniture and equipment stores
58	Eating and drinking places
591	Drug and proprietary stores
59	Miscellaneous retail stores (e.g., sporting goods, bicycle shops, florists, and the like)

Estimation of the Tax Base

The primary source of data from which estimates of retail sales in Montana are made is the 1982 Census of Retail Trade. The U.S. Bureau of Census is compiling data for 1987, but this information will not be available until early 1989. Sales and Marketing Management (Market Statistics), a private reporting group, provides more current information on retail sales volume for Montana and every other state, but in insufficient detail to be of much value except as a means of comparison with projections based on 1982 census data.*

Under some reasonable assumptions about the comparability of retail sales in Montana to retail sales in Washington, a method was developed to project retail sales by three-digit SIC industry from 1983 through 1991.** Data from the 1977 and 1982 economic censuses of retail trade indicate a close correspondence of sales in Montana to sales in Washington. In those years, the dollar volume of retail trade in Montana was about 20 percent of that in Washington, both in total sales and, in many instances, by kind of business.

If this proportionality in sales holds over time, which is the basic assumption adopted for this sector, then the ratio of the annual change in sales for a particular kind of business to the annual change in disposable personal income in Washington can be used in conjunction with the annual change in disposable personal income in Montana to estimate the annual change in sales in Montana. For example, if sales by clothing stores in Washington showed an annual increase of 6 percent and disposable personal income went up by 3 percent, the ratio is 6 divided by 3, or 2. When applied to Montana, this means that every 1 percent change in income gives rise to a 2 percent change in sales by clothing stores.

---

*The U.S. Bureau of Census reports in the Statistical Abstract of the United States Sales and Marketing Management figures for state-level estimates of retail trade between census years.

**See the discussion of methodology in the services sector for a description of the technique used to account for sales by establishments without payroll.

The Washington state sales tax reporting system provides detailed information on gross and taxable sales for each three-digit SIC kind of business in retail trade by calendar year. Using 1982 as the base year, annual ratios for each kind of business for the period 1983 through 1986 were calculated based on changes in gross retail sales and changes in Washington's disposable personal income.

These ratios may be positive or negative. If a particular ratio is negative, that means sales have declined from the previous year. An important industry in which this occurs is service stations (SIC 554). Projected sales in this category for 1986 are less than reported sales in 1982.

Multiplying these ratios by the corresponding annual change in disposable personal income in Montana gives the annual change in sales for each kind of business in the state. Adding that change (either positive or negative) to sales in the prior year gives the estimate of current year sales.*

Projections of sales for the period 1987 through 1991 were calculated by applying the average of the ratio from 1983 through 1986 for each kind of business to the forecasted annual change in disposable personal income in Montana (obtained from the Montana Office of Budget and Program Planning).

---

*This method uses observed changes in retail trade and disposable personal income in Washington to estimate changes in retail trade in Montana. These ratios do not signify behavioral responses to changes in personal income or cause and effect relationships typically associated with these ratios.

This procedure was used for each kind of business except for new-and used-car dealers. The initial results obtained by using this method indicated that projected sales in this category were about 18 percent higher than reported by Sales and Marketing Management in 1986. An examination of the number of new registrations of automobiles in the state confirmed the suspicion that the estimate for car sales may be too high. Because sales by auto dealers can account for up to one-fifth of total retail sales, a revised estimate was made. Projected sales were based on the historical growth rates in disposable personal income in Montana (1983 to 1986) and on forecasted disposable income (1987 to 1991).

Table 2 compares projected retail sales in 1986 with estimates reported in the 1988 Statistical Abstract of the United States. Estimates for total retail trade differ by slightly more than 3 percent. Large variations occur in building material stores (SIC 52), general merchandise stores (SIC 53), apparel stores (SIC 56), and drug stores (SIC 591). No adjustments were made for these industries because: (1) the greater level of detail associated with the estimates presented in this report cannot easily be reconciled with the less detailed sales figures reported in the Statistical Abstract; (2) the absolute differences are relatively small; and (3) there is no reason to assume a greater degree of confidence in the published estimates than in the estimates resulting from the method presented herein.

TABLE 2

Estimates of Retail Trade Compared to Survey of Buying Power
1986
In Millions of Dollars

Industry	Col. 1 Report Estimate	Col. 2 Survey of Buying Power	Col. 1- Col 2	Percentage Difference
Retail Trade	4,568	4,717	-149	-3.2%
Building Materials Dealers	307	382	-75	-19.6%
General Merchandise Stores	373	420	-47	-11.2%
Food Stores	1,078	1,117	-39	-3.5%
Grocery Stores	1,038	1,077	-39	-3.6%
Automotive Dealers	908	929	-21	-2.3%
Service Stations	351	348	3	0.9%
Apparel & Accessories Stores	249	219	30	13.7%
Furniture & Appliance Stores	251	252	-1	-0.4%
Eating & Drinking Places	494	479	15	3.1%
Drug Stores	161	187	-26	-13.9%
Miscellaneous Retail Stores	396	384	12	3.1%

Source: U.S. Bureau of Census, Statistical Abstract of the United States: 1988
Market Statistics, New York, NY, Survey of Buying Power Data Services, annual
Montana Legislative Council

Tables 3 and 4 show an estimate of gross receipts in retail trade for 1990 and 1991 and taxable sales and revenue from a 1 percent sales tax under some different assumptions about the taxable status of consumer purchases.

Table 3 shows potential revenue from a comprehensive tax base with few exemptions. Taxable sales, derived from an adjustment factor applied against gross sales, indicate the fraction of total sales that are taxable sales. Except where noted, these adjustment factors were developed from historical patterns of the Washington state sales tax.

In no case are taxable sales 100 percent of total sales. Sales for resale, sales to the federal government, some purchases made by out-of-state residents, and receipts incidental to the tax structure are all untaxed.

Under the scenario presented in Table 3, groceries, prescription drugs, gasoline, and home heating fuel are subject to the tax. Purchases made with food stamps are exempt as required by federal law. No deduction is allowed for trade-in value. In most instances, taxable sales are in excess of 90 percent of total sales, with a few exceptions. For example, taxable sales in dairy product stores are only 64 percent of total sales. Dairy product stores (SIC 545) typically engage in wholesale activity as well as sales to final purchasers. The same holds true for fuel and ice stores (SIC 596). In each case, however, if the ratio of taxable sales to total sales were near the average for retail trade, only about $30,000 per year in additional revenue would be generated for each 1 percent of sales tax.

TABLE 3

Estimated Revenue from a 1 Percent Sales Tax
Retail Trade (Narrow-based)
1990 and 1991
In Thousands of Dollars

Industry	SIC	1990 Gross sales	1990 Adjst. factor	1990 Taxable sales	1990 Revenue from 1% tax	1991 Gross sales	1991 Adjst. factor	1991 Taxable sales	1991 Revenue from 1% tax
Retail Trade	52-59	5,425,098	***	5,051,663	50,517	5,711,711	***	5,318,230	53,182
Building materials/hardware	52	366,741	***	350,597	3,506	386,855	***	369,911	3,699
Lumber/building materials	521-522	222,087	0.973	216,091	2,161	235,399	0.973	229,043	2,290
Paint,glass,wallpaper	523	15,572	0.913	14,217	142	16,098	0.913	14,698	147
Hardware stores	525	84,060	0.956	80,361	804	88,640	0.956	84,740	847
Nurseries/garden supplies	526	6,431	0.940	6,045	60	6,655	0.940	6,256	63
Mobile home dealers	527	38,591	0.878	33,882	339	40,062	0.878	35,175	352
General merchandise	53	448,492	0.967	433,691	4,337	474,151	0.967	458,504	4,585
Food stores	54	1,206,497	***	1,095,613	10,956	1,248,009	***	1,133,298	11,333
Grocery stores	541	1,157,621	0.909	1,052,277	10,523	1,196,098	0.909	1,087,253	10,873
Fruit/vegetable/meat	542-543	19,413	0.944	18,326	183	20,471	0.944	19,325	193
Candy/nut/confectionary	544	4,155	0.938	3,897	39	4,481	0.938	4,203	42
Dairy products	545	9,821	0.638	6,266	63	10,356	0.638	6,607	66
Bakeries	546	7,964	0.979	7,797	78	8,420	0.979	8,243	82
Other food stores		7,523	0.937	7,049	70	8,183	0.937	7,667	77
Auto dealers	55	1,093,350	***	1,000,591	10,006	1,156,424	***	1,057,959	10,580
Auto dealers (new-used)	551-552	875,296	0.926	810,524	8,105	922,989	0.926	854,688	8,547
Accessory dealers	553	126,165	0.910	114,810	1,148	132,833	0.910	120,878	1,209
Marine/aircraft, etc.		91,889	0.819	75,257	753	100,601	0.819	82,392	824
Service stations	554	418,383	0.967	404,576	4,046	441,180	0.967	426,621	4,266
Apparel/accessories	56	308,752	***	300,870	3,009	329,630	***	321,203	3,212
Clothing stores	561-565	259,813	0.974	253,058	2,531	278,075	0.974	270,845	2,708
Shoe stores	566	39,660	0.984	39,025	390	41,496	0.984	40,832	408
Other accessories		9,279	0.947	8,788	88	10,058	0.947	9,525	95
Furniture/furnishings/equip.	57	325,581	***	306,662	3,067	352,572	***	332,093	3,321
Furniture stores	571	138,747	0.933	129,451	1,295	148,500	0.933	138,550	1,386
Appliance stores	572	46,557	0.956	44,508	445	49,043	0.956	46,885	469
Radio/TV/music stores	573	140,278	0.946	132,703	1,327	155,029	0.946	146,658	1,467
Eating/drinking places	58	573,580	0.959	550,063	5,501	595,458	0.959	571,044	5,710
Drug stores	591	187,212	0.950	177,851	1,779	195,882	0.950	186,088	1,861
Micellaneous retail stores	59	496,510	***	431,148	4,311	531,552	***	461,509	4,615
Miscellaneous goods	594	253,673	0.919	233,125	2,331	270,812	0.919	248,877	2,489
Nonstore retailers	596	46,978	0.822	38,616	386	49,538	0.822	40,720	407
Fuel/ice	598	24,440	0.785	19,186	192	25,772	0.785	20,231	202
Other retail stores		171,419	0.818	140,221	1,402	185,429	0.818	151,681	1,517

Source: Montana Legislative Council

Notes: Detail may not add due to rounding.
Adjustment factors for drug stores (SIC 591) and fuel/ice stores were derived from New Mexico:
the factor for service stations (SIC 554) was taken from S.M. Ghazanfar (PUBLIC FINANCE QUARTERLY, April 1975),
see discussion under the services sector.

TABLE 4

Estimated Revenue from a 1 Percent Sales Tax
Retail Trade (Narrow-based)
1990 and 1991
In Thousands of Dollars

Industry	SIC	1990 Gross sales	1990 Adjst. factor	1990 Taxable sales	1990 Revenue from 1% tax	1991 Gross sales	1991 Adjst. factor	1991 Taxable sales	1991 Revenue from 1% tax
Retail Trade	52-59	5,425,098	•••	3,841,864	38,419	5,711,711	•••	4,056,452	40,555
Building materials/hardware	52	366,741	•••	350,597	3,506	386,855	•••	369,911	3,699
Lumber/building materials	521-522	222,087	0.973	216,091	2,161	235,399	0.973	229,043	2,290
Paint,glass,wallpaper	523	15,572	0.913	14,217	142	16,098	0.913	14,698	147
Hardware stores	525	84,060	0.956	80,361	804	88,640	0.956	84,740	847
Nurseries/garden supplies	526	6,431	0.940	6,045	60	6,655	0.940	6,258	63
Mobile home dealers	527	38,591	0.878	33,882	339	40,062	0.878	35,175	352
General merchandise	53	448,492	0.910	408,127	4,081	474,151	0.910	431,477	4,315
Food stores	54	1,206,497	•••	442,872	4,429	1,248,009	•••	458,016	4,580
Grocery stores	541	1,157,621	0.371	429,477	4,295	1,196,098	0.371	443,752	4,438
Fruit/vegetable/meat	542-543	19,413	0.222	4,310	43	20,471	0.222	4,545	45
Candy/nut/confectionary	544	4,155	0.295	1,226	12	4,481	0.295	1,322	13
Dairy products	545	9,821	0.160	1,571	16	10,356	0.160	1,657	17
Bakeries	546	7,964	0.406	3,234	32	8,420	0.406	3,419	34
Other food stores		7,523	0.406	3,054	31	8,183	0.406	3,322	33
Auto dealers	55	1,093,350	•••	882,852	8,829	1,156,424	•••	933,644	9,336
Auto dealers (new-used)	551-552	875,296	0.796	696,735	6,967	922,989	0.796	734,699	7,347
Accessory dealers	553	126,165	0.910	114,810	1,148	132,833	0.910	120,878	1,209
Marina/aircraft, etc.		91,889	0.776	71,306	713	100,601	0.776	78,066	781
Service stations	554	418,383	0.177	74,054	741	441,180	0.177	78,089	781
Apparel/accessories	56	308,752	•••	300,870	3,009	329,630	•••	321,203	3,212
Clothing stores	561-565	259,813	0.974	253,058	2,531	278,075	0.974	270,845	2,708
Shoe stores	566	39,660	0.984	39,025	390	41,496	0.984	40,832	408
Other accessories		9,279	0.947	8,788	88	10,058	0.947	9,525	95
Furniture/furnishings/equip.	57	325,581	•••	298,245	2,982	352,572	•••	322,781	3,228
Furniture stores	571	138,747	0.933	129,451	1,295	148,500	0.933	138,550	1,386
Appliance stores	572	46,557	0.956	44,508	445	49,043	0.956	46,885	469
Radio/TV/music stores	573	140,278	0.886	124,286	1,243	155,029	0.886	137,356	1,374
Eating/drinking places	58	573,580	0.959	550,063	5,501	595,458	0.959	571,044	5,710
Drug stores	591	187,212	0.577	108,021	1,080	195,882	0.577	113,024	1,130
Micellaneous retail stores	59	496,510	•••	426,162	4,262	531,552	•••	456,252	4,563
Miscellaneous goods	594	253,673	0.919	233,125	2,331	270,812	0.919	248,877	2,489
Nonstore retailers	596	46,978	0.822	38,616	386	49,538	0.822	40,720	407
Fuel/ice	598	24,440	0.581	14,200	142	25,772	0.581	14,974	150
Other retail store		171,419	0.818	140,221	1,402	185,429	0.818	151,681	1,517

Source: Montana Legislative Council
Note: Detail may not add due to rounding.

Table 4 presents the narrow-based tax scenario. In this scenario, groceries, prescription drugs, gasoline, and home heating fuel are exempt. In addition, deductions from gross receipts are taken into account for the trade-in value applied to the sales price of purchased goods. The most significant application of this deduction can be seen under the auto dealers industry (SIC 551-552), where projected taxable sales under the narrow-based concept is $696.7 million in 1990 compared with the broad-based estimate of $810.5 million. The revenue impact of this deduction for auto dealers per 1 percent tax rate is $1.1 million in 1990 and $1.2 million in 1991.

Limitations of the Estimates

Gross sales in the retail trade sector and the revenue estimates presented here are strictly by kind of business. No attempt is made to provide information by merchandise line item because the methodology precluded estimates of this level of detail. To include sales by merchandise line would be to suggest a degree of precision in the estimates that is not possible to attain.

So while the estimates include (or exclude as exemptions) certain broad items (e.g., food and prescription drugs), no separate figures are available for particular kinds of goods. The revenue impact of including or excluding groceries can be (imprecisely) measured for food stores. Food stores sell the bulk of groceries, but these types of sales are not confined to just food stores.

An exemption for clothing, an unlikely but not inconceivable consideration, further illustrates the limitations associated with these estimates. Clothing stores sell primarily, but not exclusively, clothes; sales of clothes in general merchandise stores is a substantial portion of gross receipts of these establishments. Sales of clothes by other kinds of businesses are relatively minor, but all should be accounted for. A cumbersome procedure would have to be developed to establish reasonable estimates not only for clothing, but for a myriad of other possible exemptions.

As long as the exemptions are confined to the broad categories described above, the adjustment factors can be used to generate a number of revenue estimates based on the kind of exemptions involved.

The above two scenarios have been characterized as a broad-based tax or a narrow-based tax, but they both contain the services-related component of gross receipts. If services are generally excluded from the tax base, then the adjustment factor must be reduced accordingly. Depending on the type of business, the adjustment factor may be reduced by 5 to 15 percentage points.

Finally, the accuracy of the estimates is affected by the method used to derive them. The estimates of gross receipts in 1986 resulting from the methodology described herein are reasonably close to published estimates. Projections through 1991 rely on estimated changes in disposable personal income as well as an average of the ratios obtained from the preceding years (1983 to 1986), each of which is a likely source of variation from actual sales. The adjustment factors used to establish the final tax base are another source of possible variation.

It should be kept in mind that the caution on methodology applies to all sectors. This point is reiterated throughout the report but not necessarily in the same detail.

SERVICES

Applying the sales tax to services would greatly enhance revenue productivity and stability of the tax.[2] Services are defined as establishments primarily engaged in providing a wide variety of services for individuals, business and government establishments, and other organizations.

Estimation of the Tax Base

The primary source of data from which estimates of potential revenue from services are made is the 1982 Census of Service Industries. Estimates are provided for the following service industries:

SIC Code	Kind of Business
70	Hotels, motels, and other lodging places
72	Personal services
73	Business services
75	Automotive repair, services, and garages
76	Miscellaneous repair services
78, 79	Amusement and recreation services, including motion pictures

80, ex. 806	Health services, except hospitals
81	Legal services
83	Social services
89	Miscellaneous services

Estimates of service sector receipts were derived using a method similar to that developed by the Florida Department of Revenue and Taxation in estimating its sales tax base from services.

The principal assumption underlying the Florida method is that there is a stable relationship between the wages and salaries paid within an economic sector and the gross receipts from sales within that sector.

The assumption is justified by

> . . . economic evidence which shows that the services sector usually experiences low rates of growth in . . . productivity. This condition is dictated by the labor intensive nature of services, which allows only a limited opportunity for technological innovation.[3]

If this assumption holds true, then changes in wages and salaries can be used to project sales.

An examination of the ratio of gross receipts to payroll from the 1972, 1977, and 1982 Census of Service Industries, Montana indicates that a stable relationship exists between these two variables for most service industries at the two-digit SIC level. Table 5 shows the historical trend in the ratios of gross receipts to payroll since 1972.

TABLE 5

Ratio of Gross Receipts to Payroll By Service Industry

	1972	1977	1982
Hotels, Motels, and Other Lodging Places	3.7	3.9	3.9
Personal Services	3.0	2.9	3.0
Business Services	2.4	2.7	2.5
Automotive Repair Services	4.2	4.2	4.2
Miscellaneous Repair Services	3.6	3.4	3.4
Amusement and Recreation Services	3.7	4.0	4.8
Health Services, Except Hospitals	NA	NA	2.4
Offices of Physicians	NA	2.6	2.2
Offices of Dentists	NA	3.9	3.0
Offices of Optometrists	NA	8.5	5.0
Nursing and Personal Care	NA	2.0	2.1
Legal Services	5.5	3.9	3.3
Engineering, Architecture, Surveying	NA	2.3	2.1
Accounting, Auditing, Bookkeeping	2.1	2.5	2.4
Social and Other Services	NA	2.2	2.4

NA: Not available

Source: U.S. Bureau of Census, 1972, 1977, 1982 Census of Service Industries, Montana

Using 1977 and 1982 census data, a more detailed comparison was made by the kind of business for which gross receipts were estimated. The ratios for these two years showed, in most cases, a one-tenth to two-tenths percentage point difference. Larger differences occurred in amusement and recreation (SIC 78-79) and health services (SIC 80). The ratios for several of the amusement and recreation industries were higher in the amusement and recreation industries were higher in 1982, while health services were generally lower. No adjustments were made for these differences, and the 1982 ratios for each kind of business were used in later calculations.

The first step in estimating the level of gross receipts in the service industries for 1990 and 1991 was to project payroll figures through 1991. For the period 1983 to 1986 changes in 2-digit SIC wage and salary disbursements (U.S. Bureau of Economic Analysis, unpublished data) were used to estimate changes in payroll for each kind of business.

Wages and salaries were used because they cover nearly 95 percent of labor income in most industries and more accurately reflect changes on an industry-by-industry basis. Data on wages and salaries is also more current than payroll data reported by the Bureau of Census in its annual report County Business Patterns. In addition, payroll data in those reports may not always be consistent with data from the economic censuses.

Some detail is lost by using wages and salaries because they are reported at the two-digit SIC level, whereas the estimates in this report are for three-digit industries. Using this method to estimate changes in wages and salaries, however, did not produce any great disparities with reported payroll information. In those few instances where some difference was observed (e.g., business services), it was assumed that the gross-receipts-to-payroll ratio obtained from 1982 census data would minimize the difference.

Changes in payroll through 1991 were similarly derived from changes in forecasted wages and salaries furnished by the Office of the Montana Legislative Fiscal Analyst.

Estimates of gross receipts by kind of business for 1990 and 1991 were calculated by multiplying projected payroll by its 1982 ratio of gross receipts to payroll. That amount had to be increased to account for establishments without payroll.

The Census Bureau normally reports combined data on gross receipts from all establishments and also provides separate information on establishments with payroll. The term "all establishments" includes businesses with payroll as well as those without payroll (i.e., unincorporated proprietorships and partnerships). The Census Bureau uses Internal Revenue Service (IRS) administrative records for data on businesses without payroll. For 1982, the combined data for all establishments were not included in the economic census because many businesses without payroll were miscoded by IRS in miscellaneous categories rather than being classified in the specific kind of business.[4]

To determine the proportion of receipts attributable to firms without payroll, the 1977 Census of Service Industries was used. For each kind of business the percentage difference between receipts for establishments with payroll and total receipts was calculated; gross receipts were then increased by that percentage difference.[*] For example, in 1977 hotels and other lodging places (SIC 70) with payroll had receipts of $96.7 million, while total receipts for the industry were $103.7 million, or 7.2 percent greater. Estimated gross receipts for hotels and other lodging places were therefore increased by 7.2 percent.

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[*] The corresponding differences in retail trade between sales by all establishments and sales by establishments with payroll are generally smaller than is the case with services.

Similarly, total receipts in legal services (SIC 81) were 11 percent greater than those for firms with payroll, so gross receipts for legal services were increased by 11 percent.

Table 6 shows potential revenue from a broad-based tax on services, and Table 7 shows revenue if services are generally exempt. In the case of services, the terms "broad-based" and "narrow-based" are descriptive of the taxable status of the industry rather than the taxable status of products or merchandise.

Generally, receipts in the service industries come almost exclusively from services rendered or from some combination of services and merchandise. Barbershops are an example of the first type and auto repair shops are an example of the second.

A broad-based tax on services (Table 6) would include both labor services and merchandise. The adjustment factors for the broad-based tax were adopted from New Mexico's ratio of gross receipts to taxable receipts in fiscal year 1987. The adjustment factors apply only to the two-digit industry groups because New Mexico does not report information in any greater detail. The only exception is meals and drinks at hotels and other lodging (SIC 70), where the factor established for eating and drinking in retail trade is used.

TABLE 6

Estimated Revenue from a 1 Percent Sales Tax
Service Industries (Broad-based)
1990 and 1991
In Thousands of Dollars

Industry	SIC	1990 Gross sales	1990 Adjust. factor	1990 Taxable sales	1990 Revenue from 1% tax	1991 Gross sales	1991 Adjust. factor	1991 Taxable sales	1991 Revenue from 1% tax
Services	70-89	1,802,604	•••	1,559,479	15,595	1,925,549	•••	1,667,598	16,676
Hotels and other lodging	70	234,261	•••	202,996	2,030	245,997	•••	213,166	2,132
Room rental		158,595	0.840	133,220	1,332	166,540	0.840	139,894	1,399
Meals and drinks		52,240	0.959	50,098	501	54,857	0.959	52,608	526
Other		23,426	0.840	19,678	197	24,600	0.840	20,664	207
Personal services	72	101,890	•••	94,961	950	108,533	•••	101,153	1,012
Laundry,cleaning,and garment	721	33,124	0.932	30,872	309	35,284	0.932	32,885	329
Beauty and barber shops	723-724	32,960	0.932	30,719	307	35,109	0.932	32,722	327
Funeral services	726	16,782	0.932	15,641	156	17,876	0.932	16,661	167
Other personal services		19,023	0.932	17,730	177	20,264	0.932	18,886	189
Business services	73	278,779	•••	225,532	2,255	305,932	•••	247,499	2,475
Advertising	731	15,685	0.809	12,689	127	17,212	0.809	13,925	139
Services to buildings	734	31,130	0.809	25,184	252	34,162	0.809	27,637	276
Computers and data processing	737	35,805	0.809	28,966	290	39,292	0.809	31,787	318
Management,consulting,& pub.rel.	739	52,290	0.809	42,303	423	57,383	0.809	46,423	464
Equipment rental,leasing	739	28,354	0.809	22,938	229	31,115	0.809	25,172	252
Credit reporting/collection	732	14,782	0.809	11,959	120	16,222	0.809	13,124	131
Testing laboratories	739	9,545	0.809	7,722	77	10,475	0.809	8,474	85
Detective and protective serv.	739	11,118	0.809	8,995	90	12,201	0.809	9,871	99
Photofinishing labs	739	17,694	0.809	14,315	143	19,417	0.809	15,709	157
Other business services		62,375	0.809	50,461	505	68,450	0.809	55,376	554
Automotive repair and services	75	136,191	•••	111,132	1,111	136,191	•••	111,132	1,111
Repair and services	752-754	115,475	0.816	94,228	942	115,475	0.816	94,228	942
Rental and leasing	751	20,717	0.816	16,905	169	20,717	0.816	16,905	169
Miscellaneous repair services	76	54,041	0.655	35,397	354	54,992	0.655	36,020	360
Amusement and recreation services	78-79	114,734	•••	96,863	969	123,527	•••	104,115	1,041
Motion picture theatres	783	14,450	0.950	13,727	137	14,146	0.950	13,439	134
Bowling alleys and pool halls	793	25,001	0.829	20,726	207	27,268	0.829	22,605	226
Commercial sports	794	3,488	0.829	2,892	29	3,804	0.829	3,154	32
Public golf courses	799	3,616	0.829	2,997	30	3,943	0.829	3,269	33
Amusement device operators	799	17,032	0.829	14,119	141	18,577	0.829	15,400	154
Membership clubs	799	14,226	0.829	11,793	118	15,516	0.829	12,863	129
Other recreation services		36,922	0.829	30,609	306	40,271	0.829	33,385	334
Health services, except hospitals	80	497,636	•••	472,754	4,728	537,148	•••	510,290	5,103
Offices of physicians	801	278,344	0.950	264,427	2,644	300,445	0.950	285,423	2,854
Offices of dentists	802	93,748	0.950	89,060	891	101,191	0.950	96,132	961
Offices of optometrists	804	19,504	0.950	18,528	185	21,052	0.950	20,000	200
Nursing and personal care	805	59,078	0.950	56,124	561	63,768	0.950	60,580	606
Other health services		46,962	0.950	44,614	446	50,691	0.950	48,157	482
Legal services	81	208,590	0.950	198,160	1,982	228,552	0.950	217,124	2,171
Engineering, architecture, survey	891	80,199	0.751	60,230	602	83,359	0.751	62,603	626
Accounting, auditing, bookkeeping	891	58,905	0.726	42,765	428	61,226	0.726	44,450	444
Social and other services	83,89	37,378	0.500	18,689	187	40,092	0.500	20,046	200

Source: Montana Legislative Council
Note: Detail may not add due to rounding

TABLE 7

Estimated Revenue from a 1 Percent Sales Tax
Service Industries (Narrow-based)
1990 and 1991
In Thousands of Dollars

Industry	SIC	1990 Gross sales	1990 Adjust. factor	1990 Taxable sales	1990 Revenue from 1% tax	1991 Gross sales	1991 Adjust. factor	1991 Taxable sales	1991 Revenue from 1% tax
Services	70-89	1,802,604	•••	490,809	4,908	1,925,549	•••	516,395	5,164
Hotels and other lodging	70	234,261	•••	202,996	2,030	245,997	•••	213,166	2,132
Room rental		158,595	0.840	133,220	1,332	166,540	0.840	139,894	1,399
Meals and drinks		52,240	0.959	50,098	501	54,857	0.959	52,608	526
Other		23,426	0.840	19,678	197	24,600	0.840	20,664	207
Personal services	72	101,890	•••	12,776	128	108,533	•••	13,609	136
Laundry,cleaning,and garment	721	33,124	0.038	1,259	13	35,284	0.038	1,341	13
Beauty and barber shops	723-724	32,960	0.039	1,285	13	35,109	0.039	1,369	14
Funeral services	726	16,782	0.400	6,713	67	17,876	0.400	7,151	72
Other personal services		19,023	0.185	3,519	35	20,264	0.185	3,749	37
Business services	73	278,779	•••	44,507	445	305,932	•••	48,842	488
Advertising	731	15,685	0.115	1,804	18	17,212	0.115	1,979	20
Services to buildings	734	31,130	0.115	3,580	36	34,162	0.115	3,929	39
Computers and data processing	737	35,805	0.115	4,118	41	39,292	0.115	4,519	45
Management,consulting,& pub.rel.	739	52,290	0.115	6,013	60	57,383	0.115	6,599	66
Equipment rental,leasing	739	28,354	0.554	15,708	157	31,115	0.554	17,238	172
Credit reporting/collection	732	14,782	0.115	1,700	17	16,222	0.115	1,866	19
Testing laboratories	739	9,545	0.115	1,098	11	10,475	0.115	1,205	12
Detective and protective serv.	739	11,118	0.115	1,279	13	12,201	0.115	1,403	14
Photofinishing labs	739	17,694	0.115	2,035	20	19,417	0.115	2,233	22
Other business services		62,375	0.115	7,173	72	68,450	0.115	7,872	79
Automotive repair and services	75	136,191	•••	74,642	746	136,191	•••	74,642	746
Repair and services	752-754	115,475	0.500	57,737	577	115,475	0.500	57,737	577
Rental and leasing	751	20,717	0.816	16,905	169	20,717	0.816	16,905	169
Miscellaneous repair services	76	54,041	0.297	16,050	161	54,992	0.297	16,333	163
Amusement and recreation services	78-79	114,734	•••	96,863	969	123,527	•••	104,115	1,041
Motion picture theatres	783	14,450	0.950	13,727	137	14,146	0.950	13,439	134
Bowling alleys and pool halls	793	25,001	0.829	20,726	207	27,268	0.829	22,605	226
Commercial sports	794	3,488	0.829	2,892	29	3,804	0.829	3,154	32
Public golf courses	799	3,616	0.829	2,997	30	3,943	0.829	3,269	33
Amusement device operators	799	17,032	0.829	14,119	141	18,577	0.829	15,400	154
Membership clubs	799	14,226	0.829	11,793	118	15,516	0.829	12,863	129
Other recreation services		36,922	0.829	30,609	306	40,271	0.829	33,385	334
Health services, except hospitals	80	497,636	•••	18,652	187	537,148	•••	20,133	201
Offices of physicians	801	278,344	0.010	2,783	28	300,445	0.010	3,004	30
Offices of dentists	802	93,748	0.020	1,875	19	101,191	0.020	2,024	20
Offices of optometrists	804	19,504	0.500	9,752	98	21,052	0.500	10,526	105
Nursing and personal care	805	59,078	0.040	2,363	24	63,768	0.040	2,551	26
Other health services		46,962	0.040	1,878	19	50,691	0.040	2,028	20
Legal services	81	208,590	0.010	2,086	21	228,552	0.010	2,286	23
Engineering, architecture, survey	891	80,199	0.126	10,105	101	83,359	0.126	10,503	105
Accounting, auditing, bookkeeping	891	58,905	0.126	7,422	74	61,226	0.126	7,714	77
Social and other services	83,89	37,378	0.126	4,710	47	40,092	0.126	5,052	51

Source: Montana Legislative Council
Note: Detail may not add due to rounding

The adjustment factors are always less than 1 for many of the same reasons described in the retail trade sector. The adjustment factors are generally lower for business (SIC 73) and professional services (SIC 891) than for other establishments. This implies that a larger proportion of sales arise from "intermediate" services (sales for resale) and not from sales to final purchasers. For example, receipts of a subcontractor from a management and consulting firm would ostensibly be exempt. This exemption would avoid "pyramiding" (or double taxing) the intermediate service.

Conversely, the magnitude of the adjustment factors may suggest that there is significant tax pyramiding with respect to business and professional services.

The adjustment factor for health services (excluding hospitals) and legal services implies that nearly 95 percent of gross receipts would be subject to the tax as sales to final consumers.

Potential revenue from a broad-based tax of 1 percent on services would yield about $15.6 million in 1990 and $16.7 million in 1991. Hotels, motels, and other lodging places are subject to a 4 percent accommodations tax that provides revenue for tourism promotion. If the "bed tax" portion is excluded from a sales tax, total revenue from those establishments would have to be reduced accordingly.

Under a narrow-based concept of sales taxation (i.e., services generally exempt), only the merchandise sold in the services sector would be subject to the tax. While it is impossible to identify accurately the proportion of merchandise included in gross receipts in services, some adjustment is necessary to account for those sales.

The adjustment factors shown in Table 7 were adapted from a study on the revenue potential of a sales tax on services in Idaho by S.M. Ghazanfar.[5] Ghazanfar developed adjustment ratios to estimate nontaxable sales in services that could be taxed. The remaining portion (i.e., 1 minus the adjustment factor) would represent the amount of gross receipts currently taxed. The adjustment ratios developed by Ghazanfar had limited applicability. They only included estimates for personal services (SIC 72), business services (SIC 73), auto repairs (SIC 75), and miscellaneous repairs (SIC 76).

Conspicuously absent from Ghazanfar's work were estimates for health, professional, and legal services. The ratios developed by him were based on the 1967 Census of Business, Selected Services for Idaho. At that time, census coverage did not include those service industries. Separate adjustment factors for these industries were developed for this report from the ratio of 1982 taxable sales in Idaho to 1982 gross receipts in Idaho reported by the Census Bureau.

Because Idaho taxes amusement and recreation services (SIC 79), the adjustment factors (i.e., those developed from New Mexico) are the same as in the broad-based scenario. Revenue potential from a narrow-based tax of 1 percent on services in Montana is estimated to be $4.9 million in 1990 and $5.2 million in 1991, or about one-third of the amount generated by the broad-based tax. Exclusion of the amount already dedicated from the accommodations tax reduces significantly (by about

26 percent) revenue that can be used for other purposes.

Limitations of the Estimates

The adjustment factors adopted from New Mexico under the broad-based sales tax scenario limit the ability to make alternative revenue estimates based on different assumptions of taxation in this sector. This limitation is due to the application of an adjustment factor that is relevant only at the two-digit level to the kinds of businesses for which more detailed information is available. For example, there is likely to be a wide range of adjustment factors by kind of business in business services that would better reflect the revenue potential (or loss), depending on the taxable status of establishments within this industry.

The adjustment factors developed under the narrow-based approach can be interchanged with those for the broad-based approach to enhance, to a certain extent, the versatility of the estimates. However, the application of the sales tax base of a comparison state imposes the definitional and legal structure of the comparison state on these estimates. As a result, the precision of the estimates is impaired.

WHOLESALE TRADE

Depending on the structure of the tax and the rules that govern the taxability of sales, the wholesale trade sector could provide anywhere from $3 million to $9 million for each 1 percent of tax.

Wholesale trade includes businesses primarily engaged in selling merchandise to retailers; to industrial, commercial, institutional, farm, or professional business users; or to other wholesalers.

Businesses selling merchandise to contractors are included in wholesale trade, with the exception of lumberyards and stores that sell paint, glass, or wallpaper. These exceptions are classified in retail trade if they sell to the general public.

Wholesale trade sales are typically exempt from the sales tax if the merchandise sold is for resale. There are two types of sale for resale: (1) purchases made by a business for later sale to its customers; and (2) purchased items that become an ingredient or component part of some other taxable item. The purpose of the sale-for-resale exemption is to avoid taxing sales at more than one level of production and distribution (pyramiding).

Estimation of the Tax Base

Two separate revenue estimates are presented for this sector. The first, a broad-based estimate, was developed by applying to Montana historical trends in wholesale trade in New Mexico. The second, a narrow-based estimate, used trends in Idaho.

The 1982 Census of Wholesale Trade for the three states provides the starting point for the estimates. In 1982, total wholesale trade amounted to $4.9 million in Montana and $5.1 million in both Idaho and New Mexico.

Approximately 60 percent of total wholesale trade sales in New Mexico and about 40 percent in Idaho are reported as gross receipts on sales tax reports. Appropriate percentages for each two-digit industry within the sector were developed by comparing 1982 census information with gross receipts shown on sales tax reports from New Mexico and Idaho for the same year. These percentages from the two comparison states were used to estimate the 1982 level of reportable gross receipts in Montana under a broad-based tax (New Mexico) and a narrow-based tax (Idaho).

Changes in wholesale trade from 1982 to 1986 are based on the ratio of annual changes in reportable gross receipts to annual changes in disposable personal income in the comparison state applied to changes in disposable personal income in Montana. Projections through 1991 are based simply on forecasted changes in disposable personal income in Montana. Adjustment ratios determine the fraction of gross receipts that are taxable.

A broad-based sales tax would generate approximately $8.7 million in 1990 and about $9.2 million in 1991 for each 1 percent of tax. (See Table 8.) A narrow-based tax would yield approximately $3.1 million and $3.4 million, respectively. (See Table 9.)

The major differences in the level of estimated revenue in the comparison states occur in the categories of machinery and equipment (SIC 508) and miscellaneous wholesale trade. New Mexico taxes most machinery and equipment sales, including agricultural machinery and equipment (but at a lower effective rate); Idaho does not.

TABLE 8

Estimated Revenue from a 1 Percent Sales Tax
Wholesale Trade (Broad-based)
1990 and 1991
In Thousands of Dollars

		1990				1991			
	SIC	Gross sales	Adjust. factor	Taxable sales	Revenue from 1% tax	Gross sales	Adjust. factor	Taxable sales	Revenue from 1% tax
Wholesale Trade	50-51	3,956,311	***	861,413	8,614	4,157,114	***	902,131	9,021
Motor vehicles and equipment	501	234,089	0.190	44,477	445	246,844	0.190	46,900	469
Drugs, chemicals, and allied products	512,516	110,259	0.228	25,139	251	116,267	0.228	26,509	265
Groceries and related products	514	578,390	0.042	24,292	243	609,906	0.042	25,616	256
Electrical goods and household appliances	506	114,733	0.346	39,698	397	120,985	0.346	41,861	419
Hardware, plumbing, and heating equipment	507	80,509	0.184	14,814	148	84,896	0.184	15,621	156
Machinery and equipment	508	540,053	0.452	244,104	2,441	569,480	0.452	257,405	2,574
Miscellaneous	509-519	2,027,178	0.175	354,756	3,548	2,137,636	0.175	374,086	3,741
Petroleum and petroleum products	517	271,100	0.421	114,133	1,141	271,100	0.421	114,133	1,141

Source: Montana Legislative Council

Note: Detail may not add due to rounding.

TABLE 9

Estimated Revenue from a 1 Percent Sales Tax
Wholesale Trade (Narrow-based)
1990 and 1991
In Thousands of Dollars

Industry	SIC	1990 Gross sales	1990 Adjust. factor	1990 Taxable sales	1990 Revenue from 1% tax	1991 Gross sales	1991 Adjust. factor	1991 Taxable sales	1991 Revenue from 1% tax
Wholesale Trade	50-51	2,613,010	***	314,398	3,144	2,755,389	***	331,529	3,315
Motor vehicles and equipment	501	179,570	0.193	34,657	347	189,355	0.193	36,545	365
Drugs, chemicals, and allied products	512,516	252,605	0.022	5,557	56	266,369	0.022	5,860	59
Groceries and related products	514	314,506	0.043	13,524	135	331,643	0.043	14,261	143
Electrical goods and household appliances	506	135,190	0.337	45,559	456	142,556	0.337	48,042	480
Hardware, plumbing, and heating equipment	507	143,939	0.348	50,091	501	151,782	0.348	52,820	528
Machinery and equipment	508	***	***	***	***	***	***	***	***
Miscellaneous	509-519	333,124	0.149	49,635	496	351,275	0.149	52,340	523
Petroleum and petroleum products	517	1,254,076	0.092	115,375	1,154	1,322,408	0.092	121,662	1,217

Source: Montana Legislative Council

Note: Detail may not add due to rounding.

The difference in the miscellaneous category cannot be readily explained. This category contains a wide variety of wholesale operations, including, among other things, clothing, lumber and paper products, furniture, farm products and supplies, sporting goods, and metals and minerals. The wholesaler's function within the economy and the kind of merchandise sold determine to a large extent the taxability of goods sold within the sector. The amount of tax revenue generated depends on the level of sales and the precise rules that govern the taxability of sales.

Limitations of the Estimates

The estimates of revenue potential for wholesale trade illustrate the difference between adopting a broad-based sales tax and a narrow-based sales tax. While likely to contain a wide margin of error, the estimates indicate the likely range of revenue potential from this sector.

There are several areas that affect the magnitude of error. First, it was necessary to use two states as models in developing the high and low estimates. Each state has its own peculiar economic structure and pattern of growth. Montana's economy resembles Idaho's more than New Mexico's, but that does not mean the economic sectors within Montana and Idaho expand or contract in a similar manner.

The method employed to develop the estimates assumes a highly positive correlation between changes in disposable personal income and changes in gross receipts. While the correlation may be valid for one comparison state, it certainly cannot be true for both.

To the extent sales in this sector are made to businesses rather than individuals, changes in personal income may be a poor indicator of changes in gross receipts.

In addition, the use of adjustment factors assumes that the ratio of taxable sales to gross receipts is constant over time. It also assumes a consistency in reporting by businesses. Whether either one of these assumptions has any basis in fact, is uncertain and probably unprovable.

Finally, the estimates cannot be easily manipulated to derive other revenue estimates under different assumptions of the taxable status of goods sold. For example, under the New Mexico model, farm machinery is included in the estimate for machinery and equipment, but a separate estimate is not made for the value of farm machinery that may be subject to the tax.

The problems inherent in making reliable estimates for wholesale trade clearly demonstrate the difficulties associated with defining and quantifying the tax base.

CONTRACT CONSTRUCTION

The inclusion of contract construction in a general sales tax base can generate a significant amount of revenue. The term "construction" includes new work, additions, alterations, and repair. Revenue estimates for this sector are divided into three broad industries:

SIC Code	Kind of Business
15	General building contractors
16	Heavy construction contractors
17	Special trade contractors

General building contractors are primarily engaged in the construction of dwellings, office buildings, stores, farm buildings, and other projects of a similar nature.

Heavy construction contractors are engaged primarily in the construction of highways, streets, bridges and tunnels; docks, piers, dams, and water projects; sewage collection, treatment, and disposal facilities; air fields; heavy industrial facilities; and other construction that involves either earthmoving or the erection of structures and appurtenances other than buildings.

Special trade contractors are primarily engaged in specialized construction activities, such as plumbing, painting, electrical work, and carpentry. Special trade contractors may work for general contractors under subcontracts or directly for the owner of the property.

Estimation of the Tax Base

Again, 1982 is the base year from which projections are made. Data for that year were obtained from the 1982 Census of Construction Industries, Mountain States. The estimates are based on total business receipts by industry. In addition to construction sales, they may include receipts from retail and wholesale trade; rental of property and equipment; manufacturing, engineering, and architectural work done for others;

and other nonconstruction activity--all of which may be subject to the tax.

Because materials make up such a large portion of construction activity, total receipts in 1982 were adjusted for inflation. Changes in receipts through 1986 are driven by real changes (adjusted for inflation) in wages and salaries for each industry in the sector.

Construction activity can be highly volatile; therefore, projections for 1987 through 1991 assume that no real growth in the construction industry will occur. Changes in construction receipts are tied to changes in the producer price index for the construction industry provided by Wharton Econometrics (1987).

Table 10 presents the estimated revenue from contract construction. Potential revenue for every 1 percent of tax is slightly over $7 million per year.

The adjustment factors for Montana were derived from the ratio of taxable receipts to gross receipts in New Mexico. Total receipts for each industry contain varying amounts of duplication because construction work (and the receipts) may be subcontracted to others and be included in the subcontractors' receipts. The level of the adjustment ratios indicates that much of this duplication (sale for resale), especially for subcontractors (SIC 17), is eliminated in the tax structure.

TABLE 10

Estimated Revenue from a 1 Percent Sales Tax
Contract Construction
1990 and 1991
In Thousands of Dollars

		1990			
Industry	SIC	Gross sales	Adjst. factor	Taxable sales	Revenue from 1% tax
Contract Construction	15-17	1,053,346	***	714,234	7,142
General Building Contractors	15	357,799	0.845	302,340	3,023
Heavy Construction Contractors	16	270,626	0.828	224,078	2,241
Special Trade Contractors	17	424,921	0.442	187,815	1,878

		1991			
Industry	SIC	Gross sales	Adjst. factor	Taxable sales	Revenue from 1% tax
Contract Construction	15-17	1,082,222	***	733,622	7,336
General Building Contractors	15	366,851	0.845	309,989	3,100
Heavy Construction Contractors	16	278,339	0.828	230,465	2,305
Special Trade Contractors	17	437,032	0.442	193,168	1,932

Source: Montana Legislative Council

Note: Detail may not add due to rounding

Limitations of the Estimates

The estimates for contract construction are based on the full contract price for construction for each industry within the sector. The contract price includes both materials and labor costs. If materials are the only element subject to the tax, then the labor component must be taken out.

The estimates also include receipts from nonconstruction activity. The method used to make the projections may overstate or understate the relative importance of these receipts to the total. But, depending on the structure of the tax, these receipts must be accounted for. For example, a system could be designed where the contractor (or builder) is the owner of the construction materials and therefore has paid the sales tax. This transaction could have occurred in either retail or wholesale trade and could be recorded in either sector. However, nonconstruction receipts, if taxable, would be recorded in the construction sector.

TRANSPORTATION, COMMUNICATIONS, AND PUBLIC UTILITIES

The transportation, communications, and public utilities sector (TCPU) furnishes services to the general public or to other business. These services include passenger and freight transportation, communications (e.g., telephone services and radio and television broadcasting), electric and gas utilities, and water and sanitary services.

Many industries in this sector are regulated by the Montana Public Service Commission (PSC), and reporting requirements provide much more current information on sales than is available from other sectors. Data for this sector was provided by the PSC, the Montana Department of Revenue, and, in several instances, by the regulated industries.

Estimates for potential revenue from a 1 percent sales tax were developed for rail transportation, passenger and motor freight transportation, pipelines, telephone services, and public utilities (electricity, gas, and sewer and water). The estimates are based on regulated revenue only--that is, the gross receipts for services performed in Montana for the benefit of in-state customers.

The categories of passenger transportation and motor freight include bus and taxi services, moving and storage, garbage disposal, and intrastate transportation of such goods as grain, lumber, and oil field equipment. Pipelines involve the intrastate shipment of oil and gas.

Estimates for telephone receipts include local service and intrastate and interstate long distance calls as well as services provided by local telephone cooperatives. Little growth is anticipated in the industry during the next few years, although rapid changes in industry structure may affect revenue potential.

Estimates of gross sales for electric and gas utilities were provided by the major utilities operating in the state. Estimates for the smaller gas companies and rural electric cooperatives are based on their historical share of sales within the state.

Most sewer and water systems in the state are owned by local governments and operated as enterprise funds, with revenue coming from user charges. Water and sewer systems may be metered or unmetered or have some combination of both. Nearly 85 percent of sewer and water sales come from municipal systems.

Adjustment factors used to determine taxable sales from gross receipts are based on the ratio of taxable sales to gross receipts in New Mexico. Under a broad-based sales tax of 1 percent, the TCPU sector would provide around $10 million annually. (See Table 11.)

Limitations of the Estimates

The estimates for this sector suffer from a number of limitations. First, the estimates do not include information for unregulated industries. Industries not regulated, such as telegraph, radio and television broadcasting, cable TV, and air transportation, are not part of the estimates.

To reiterate, the estimates include regulated revenue only. Establishments in the TCPU sector, particularly motor freight transportation (SIC 42), may have substantial sales not covered by regulatory authority but which may be subject to the sales tax. The PSC collects information on nonregulated revenues of regulated utilities, but does not summarize or report it.

Finally, different assumptions about the taxable status of services provided in this sector cannot be easily accounted for.

Adjustments can be made with respect to gas and electric utilities based on the class of service or end user (i.e., residential, commercial, industrial) or on telephone service based on the kind of service used (local versus long distance calls). Because of the level of detail, adjustments cannot be made for other industries in the sector.

TABLE 11

Estimated Revenue from a 1 Percent Sales Tax
Transportation, Communication, and Public Utilities
1990 and 1991
In Thousands of Dollars

		1990				1991			
Industry	SIC	Gross sales	Adjust. factor	Taxable sales	Revenue from 1% tax	Gross sales	Adjust. factor	Taxable sales	Revenue from 1% tax
Transportation, Communications, and Public Utilities	40-49	1,104,820	***	675,512	6,755	1,129,348	***	690,524	6,905
Railroad Transportation	40	12,500	0.980	12,250	123	12,500	0.980	12,250	123
Passenger and Motor Freight Transportation	41-42	82,351	0.055	4,529	45	84,165	0.055	4,629	46
Pipeline Transportation	46	17,800	0.142	2,528	25	17,800	0.142	2,528	25
Telephone Communications	48	293,803	***	197,142	1,971	296,741	***	199,113	1,991
Local service		108,949	0.671	73,105	731	110,039	0.671	73,836	738
Toll and access charges		169,785	0.671	113,926	1,139	171,483	0.671	115,065	1,151
Other		15,069	0.671	10,111	101	15,219	0.671	10,212	102
Electric Utilities	491	478,511	***	322,038	3,220	491,303	***	330,647	3,306
Residential		169,249	0.673	113,905	1,139	173,169	0.673	116,543	1,165
Commercial		184,004	0.673	123,835	1,238	190,197	0.673	128,003	1,280
Industrial		111,724	0.673	75,190	752	114,077	0.673	76,774	768
Other		13,534	0.673	9,108	91	13,860	0.673	9,328	93
Gas Utilities	492	165,709	***	100,585	1,006	171,288	***	103,972	1,040
Residential		75,028	0.607	45,542	455	77,165	0.607	46,839	468
Commercial		48,047	0.607	29,165	292	49,239	0.607	29,888	299
Industrial		21,125	0.607	12,823	128	22,413	0.607	13,605	136
Utility		17,826	0.607	10,820	108	18,638	0.607	11,313	113
Other		3,683	0.607	2,236	22	3,833	0.607	2,327	23
Water and Sewer Utilities	494	54,146	0.673	36,440	364	55,551	0.673	37,386	374

Source: Montana Legislative Council

Note: Detail may not add due to rounding

This sector is primarily engaged in providing services to its customers but, like all other industrial sectors within the economy, may have some sales of tangible personal property associated with the primary activity or incidental to it. No attempt has been made to estimate sales of personal property within this sector.

FINANCE, INSURANCE, AND REAL ESTATE

This sector includes establishments primarily engaged in specialized activities in either finance, insurance, or real estate (FIRE).

"Finance" includes banks and trust companies, credit agencies, other investment companies, brokers and dealers in securities and commodity contracts, and security and commodity exchanges. "Insurance" covers carriers of all types of insurance as well as insurance agents and brokers. "Real estate" includes owners, lessors, lessees, buyers, sellers, agents, and developers of real estate.

Estimation of the Tax Base

Data for financial institutions, which include banks, savings and loans, and credit unions, was obtained from the Federal Deposit Insurance Corporation (FDIC), Federal Home Loan Bank, and the Montana Credit Unions League. The estimates shown on Table 12 are for service charges on deposit accounts and other noninterest income, including charges and fees for safety deposit boxes, overdrafts, and travelers' checks as well as nonoperating income.

TABLE 12

Estimated Revenue from a 1 Percent Sales Tax
Finance, Insurance, and Real Estate
1990 and 1991
In Thousands of Dollars

Industry	SIC	1990 Gross sales	 Adjst. factor	 Taxable sales	 Revenue from 1%tax
Finance, Insurance, and Real Estate	60-65	1,179,228	***	1,043,159	10,432
Banks	60	87,393	0.708	61,874	619
Credit Unions	61	3,999	0.674	2,695	27
Savings and Loan	61	11,674	0.365	4,261	43
Security and Commodity Dealers	62	22,950	0.938	21,527	215
Insurance Agents end Carriers	63	924,000	0.900	831,600	8,316
Real Estate	65	129,212	0.938	121,201	1,212

Industry	SIC	1991 Gross sales	 Adjst. factor	 Taxable sales	 Revenue from 1%tax
Finance, Insurance, and Real Estate	60-65	1,255,819	***	1,110,911	11,109
Banks	60	93,074	0.708	65,896	659
Credit Unions	61	4,259	0.674	2,871	29
Savings and Loan	61	12,433	0.365	4,538	45
Security and Commodity Dealers	62	24,442	0.938	22,927	229
Insurance Agents and Carriers	63	984,000	0.900	885,600	8,856
Real Estate	65	137,611	0.938	129,079	1,291

Source: Montana Legislative Council

Note: Detail may not add due to rounding.

No reliable information exists on the volume of real estate commissions or on stock and commodity trading fees in Montana. Estimates for these two industries were extrapolated from New Mexico. A ratio of gross receipts to wages and salaries was calculated for each industry and applied to wages and salaries in Montana.

Information for insurance carriers was obtained from the Insurance Department of the Montana State Auditor's Office. Estimates for insurance reflect premiums written for life, health, and property and casualty insurance.

The potential revenue from a 1 percent tax from this sector ranges from $11 million to $12 million each year of the two-year period. The bulk of the revenue (over $8 million) comes from insurance premiums. (See Table 12.)

Limitations of the Estimates

The revenue estimates for this sector are, for the most part, speculative and may be the least reliable estimates presented in this report.

Gross receipts for financial institutions include nonoperating income as part of the base. Most of this income is likely beyond the reach of a sales tax. Information on nonoperating income is available from both the FDIC and private firms, but is expensive to obtain. It is not clear whether the adjustment factor fully accounts for this income.

Estimates of commissions for security and commodity dealers and real estate brokers and agents are the least reliable because there is no accurate information other than wages and salaries. When compared with New Mexico figures, however, the margin of error does not seem particularly large.

No state includes insurance premiums in its sales tax base. Including premiums in the tax base inflates to an unrealistic level the potential revenue from this sector. Without insurance sales included in the base, a maximum of slightly more than $2 million annually for each 1 percent of tax could come from this sector.

Except for customer service charges and fees, taxation in this sector is usually narrowly constructed because the principal service in these industries relates to investment rather than consumption activities.

MANUFACTURING

Manufacturing is a relatively minor component in any sales tax structure, whether broadly or narrowly defined. As Table 1 shows, manufacturing contributes between 2.6 and 5.4 percent of sales tax revenue in those selected states.

The manufacturing sector includes establishments involved in the mechanical or chemical transformation of materials or substances into new products. The new product of a manufacturing establishment may be "finished", in the sense that it is ready for utilization or consumption, or "semifinished", ready to become a raw material for an establishment engaged in further manufacturing.

It is the sale of finished products that would generally be subject to sales tax if sold by the manufacturer directly to the final consumer. Sales to employees, such as meals, would also be subject to the tax.

Estimation of the Tax Base

Estimates for manufacturing were derived by comparing the level of manufacturing activity as measured by the value of shipments in Montana (1982 Census of Manufacturing) to that of Idaho. Using this measure of comparison, the value of Montana's manufacturing sector is about 68 percent of Idaho's.

The ratio of taxable sales in manufacturing to manufacturing wages and salaries in Idaho was calculated for the years 1982 through 1986. A very stable ratio of .28 for the period was found. This means that in the manufacturing sector taxable sales are about 28 percent of wages and salaries.

A similar ratio of taxable sales to wages and salaries in manufacturing was calculated for Montana in 1982, assuming that taxable sales in that year would have been approximately 68 percent of those sales in Idaho. Using this ratio (.41), taxable sales in Montana were estimated through 1986, based on historical wage and salary information. Projections through 1991 are based on the estimated level of wages and salaries for the sector (Office of Legislative Fiscal Analyst).

Potential revenue from a 1 percent sales tax on manufacturing in 1990 is shown in Table 11 in the comparative summary section. No adjustment factors were developed because estimates are based on taxable sales rather than gross receipts. Manufacturing would provide approximately $2.2 million in 1990 and $2.4 million in 1991 for each 1 percent of tax.

Limitations of the Estimates

The estimates of revenue potential from manufacturing are sector totals rather than estimates for individual industries within the sector. The method used to calculate the estimates does not allow for different assumptions about what may or may not be taxable in this sector. Because manufacturing is a minor component in any sales tax structure, a relatively large margin of error can be tolerated.

MINING

Given the current status of the oil and gas industry in Montana, the revenue potential from mining is limited. The estimates were derived from a comparison with Wyoming, which taxes most mining services, the most important of which has been oil and gas field services. Declines in oil and gas activity over the past several years have greatly reduced sales tax collections in Wyoming. In fiscal year 1982, sales tax collections from mining amounted to $26.4 million, or 11.6 percent of the total; in fiscal year 1987, they amounted to only $9.1 million, or 5.3 percent of the total (Wyoming Department of Administration, 1987). So while this sector could provide substantial revenue, its volatility would greatly affect revenue stability.

The mining sector includes all establishments primarily engaged in mining. The term "mining" is used in the broad sense to include the extraction of minerals occurring naturally: solids, such as coal and ores; liquids, such as crude petroleum; and gases, such as natural gas. The term is also used in the broad sense to include quarrying, well operation, milling (crushing, screening, washing, flotation, etc.), and other preparation customarily done at the mine site or as a part of mining activity.

Exploration and development of mineral properties are also included within this sector. Services performed on a contract, fee, or similar basis in the development or operation of mineral properties are classified separately but within this division. Establishments that have complete responsibility for operating mines, quarries, or oil and gas wells for others on a contract, fee, or similar basis are classified according to the product mined rather than as mineral services.

Mining operations are classified by industry on the basis of the principal mineral produced or, if there is no production, on the basis of the principal mineral for which exploration or development work is in process.

Estimation of the Tax Base

Based on the 1982 Census of Mineral Industries, the level of mining activity in Montana ranged between 20 and 25 percent of that in Wyoming in a number of areas: wages and salaries, value of shipments and receipts, and value added by mining. This close correspondence is due primarily to the oil and gas industry, and accordingly the base year estimates (1982 to 1986) are tied to changes in drilling activity in the state. Projections through 1991 are based on the expected increase in the price of a barrel of oil.

The revenue potential for mining in 1990 is shown in Table 12 in the comparative summary section. At most, only about $1.1 million for each 1 percent of tax would be available from this sector in 1990 and 1991, respectively.

The estimates are conservative in that there may be a threshold price that would cause drilling activity to increase substantially, resulting in a much larger revenue potential. The estimates in Table 12 also include revenue potential from coal, metal, and nonferrous mining. Based on the Wyoming experience of the recent past, these components of the mining sector account for slightly more than 50 percent of the total, with the oil and gas industry making up the remainder. However, if oil and gas activity picks up, this industry could provide a much larger share.

Limitations of the Estimates

As is the case with manufacturing, estimates for mining are sector totals rather than estimates for separate industries within the sector. The estimates are based on the assumption that mining services (especially oil and gas field services) are the principal sources of revenue. The estimates also assume that the oil and gas industry will experience virtually no growth through 1991. If exploratory and drilling activity increases dramatically, these estimates would require major revisions.

It is impossible to provide any reliable estimate of revenue from the sale of tangible personal property (such as quarried stone or gravel) in this sector, but it can be reasonably assumed to be negligible.

AGRICULTURE AND GOVERNMENT

These two sectors are described concurrently not because of any economic similarities, but because they generally contribute insignificant amounts to sales tax revenue. Of the five states shown on Table 1, all showed that collections from agriculture made up less than 1 percent of the total, while only Idaho showed receipts from government (primarily local government) in excess of 1 percent.

Except for agricultural services, no formal estimates are provided for these two sectors. Their exclusion does not suggest that measurable revenue could not be generated, but it demonstrates the difficulty in defining and quantifying the tax base.

Agriculture

Sales of crop and livestock production would normally be exempt as raw materials for other industries or as export. Sales incidental to farm production, such as roadside fruit and vegetable stands, would be taxed to the extent food for human consumption is taxed.

The agricultural services industry (SIC 07), a major group within the agriculture sector, provides services to farm production. These include soil preparation, crop services (planting, cultivating, and harvesting), farm labor and management services, veterinary services, and landscaping. Most, but not all, of these services would represent production costs similar in nature to manufacturing production costs. A few industries included in this group, such as veterinary services and landscaping, would also provide services to the general public.

The latest year for which information is available on agricultural services gross receipts is 1978 (Census of Agricultural Services). Based on data from that year and from data on gross receipts in New Mexico for fiscal years 1986 and 1987, it seems reasonable that a ratio of 2 on gross receipts to wages and salaries would be appropriate to estimate gross receipts from wages and salaries in Montana.

In 1986 wages and salaries in agricultural services in Montana amounted to $22 million. Since 1981, wages and salaries in this sector have been growing at a brisk pace of 9.5 percent per year. Applying that rate to the 1986 figure would give wages and salaries of $32 million by 1990. A ratio of 2 on gross receipts to wages and salaries would imply sales of about $64 million in that year. Adjusting for deductions (about 43.6 percent of gross receipts) would yield about $280,000 per 1 percent of sales tax in 1990 and $309,000 in 1991. The estimate for agriculture in 1990 is included in Table 12 in the comparative summary section.

Government

Rules applying to the taxation of sales by state and local governments vary from state to state, but there is nothing in sales tax philosophy that would require governments to collect the tax on a governmental activity. Commercial activities, such as state-owned liquor stores or municipal utilities, would ordinarily be subject to the tax if it applies generally to that activity. The estimates in the preceding sections ostensibly cover those kinds of activities.

Of the five states compared in Table 1, only Idaho and New Mexico specifically report sales in this sector. The bulk of collections comes from local governments. While no comparable statistics exist for Montana, if Idaho and New Mexico are any indication, the amounts involved would be small relative to total collections.

USE TAXES

Use taxes are imposed upon goods (and services to a limited extent in some states) purchased out of state for use within the state. The purpose of the use tax is twofold: (1) to reduce the potential loss in revenue resulting from out-of-state purchases; and (2) to afford some protection to local businesses that may lose customers as a result of differential tax rates.

No specific estimate is provided here on what the use tax could generate in revenue, but it could amount to as much as 4 to 8 percent of total collections. Depending on the reach of the tax, it could be as high as 12 percent, as it is in Wyoming.

COMPARATIVE REVENUE SUMMARY BY SECTOR

This section presents a summary of potential revenue according to some general provisions regarding the tax base. The first scenario is a broad-based sales tax on most goods and services. The second is a narrow-based tax that primarily applies to goods, with some major exemptions, and to very few services. The third shows the revenue potential from the tax system proposed by the Senate version of House Bill No. 377 (1987), with some important variations. This information is shown in Table 13.

TABLE 13

Potential Revenue From a 1 Percent Sales Tax Under Three General Provisions of the Tax Base

(In Thousands of Dollars)

	Broad Based	% of Total	Narrow Based	% of Total	HB 377	% of Total
Agriculture	282	0.3	87	0.2	282	0.4
Mining	1,097	1.2	75	0.2	1,097	1.5
Contract Construction	7,142	7.6	1,267	2.5	7,142	9.6
Manufacturing	2,200	2.3	2,200	4.3	2,200	3.0
TCPU	6,755	7.2	541	1.1	6,755	9.1
Wholesale Trade	8,614	9.1	3,144	6.2	6,417	8.6
Retail Trade	50,517	53.6	38,419	75.3	39,986	53.9
Food Stores	10,956	11.6	4,429	8.7	4,429	6.0
FIRE	2,116	2.2	355	0.7	689	0.9
Services	15,595	16.5	4,908	9.6	9,613	13.0
Government	NA	NA	NA	NA	NA	NA
Total	94,318	100.0	50,996	100.0	74,181	100.0

Source: Montana Legislative Council

Note: Percentage detail may not add to 100 percent due to rounding.

BROAD-BASED TAX

The revenue potential from a broad-based tax is simply a recapitulation of the broad-based estimates developed in this report. The estimates essentially represent a gross receipts tax on the sale of goods and services, with a few exemptions (e.g., food stamp purchases) and deductions (e.g., sales for resale).

The summary excludes, for the reason noted in the financial sector (i.e., state sales taxes do not apply to insurance premiums), the estimates for insurance premiums but includes that portion from hotels, motels, and lodging already covered by the accommodations tax. A broad-based sales tax of this kind could generate about $94 million per year for each 1 percent of tax.

NARROW-BASED TAX

The narrow-based tax scenario contains many more exemptions from the sale of goods and services. For the most part, the tax base includes only the sale of tangible personal property. Food, prescription drugs, motor fuel, and home heating fuel are all exempt. The amount from lodging already committed to tourism promotion is excluded.

The figures for mining, construction, TCPU, and FIRE were derived on the basis of their relative contribution to total taxable sales (excluding use tax) in Idaho. This method of apportionment is particularly important as it relates to construction. In Idaho, construction contractors generally pay the sales tax on building materials, and those sales are recorded in retail or wholesale trade. To not adjust construction estimates in this fashion would result in double counting the tax base. The estimate for agriculture is derived from the ratio of taxable sales to gross sales from agricultural services in Idaho applied to the estimate of gross receipts ($64 million) developed in the preceding section under the agriculture sector.

The only services generally taxed in this scenario are recreation and amusement services. In the first year, the narrow-based tax would generate about $51 million for each 1 percent of tax.

HOUSE BILL NO. 377 (1987) TAX BASE

House Bill No. 377 provided for broad taxation of most goods and services. As a tax reform measure, its primary purpose was to allocate most of the revenue from the sales tax to property tax relief. This part describes what could be raised in sales tax revenue if legislation similar to House Bill No. 377 were to be enacted by the 1989 Legislature. The Senate version of the sales tax component of the bill is in the appendix. The version of House Bill No. 377 presented in the paragraphs below includes public utilities--a major deviation from the Senate version.

The estimates for agriculture, mining, construction, manufacturing, and TCPU are the same under House Bill No. 377 as they are under the broad-based tax.

Wholesale trade (derived from trends in New Mexico) is reduced by 90 percent of the estimate for machinery and equipment. The 90 percent figure was chosen somewhat arbitrarily, but it shows that the exemption of machinery and equipment does not mean there are no taxable sales in this category.

Retail trade contains exemptions for food, prescription drugs, and gasoline, but not for home heating fuel. It also excludes the deduction for trade-in value, another variation from House Bill No. 377.

The estimates for FIRE include that portion available from financial institutions. Real estate and stockbroker commissions are generally exempt.

The tax base for services is basically the same as the broad-based tax, except lodging and most advertising and health services are exempt. The potential revenue from this version of House Bill No. 377 (including utilities and home heating fuel) would initially raise about $74 million for each 1 percent of tax.

CONCLUSION

The scope of this report is strictly limited to the development of a sales tax data base. The extent to which this information can be manipulated depends on the level of sectoral detail and assumptions about the taxable status of the goods and services. The data base for retail trade and services, for example, can accommodate a fairly wide range of assumptions about taxable transactions; those for mining and manufacturing cannot. The report describes in considerable detail the limitations associated with using these estimates.

One limitation common to most of the estimates is that they began from outdated information (1982) and were pieced together from circumstantial evidence from other states. As a result, the estimates may be driven as much by the economic situation and tax codes of the comparison states as by the peculiar circumstances in Montana. Be that as it may, these estimates represent a reasonable basis from which to make revenue projections of a sales tax.

The reliability of the data base will decrease, however, the further one strays from the assumptions used to derive them. For example, the revenue impact of including or excluding food can be approximated, but estimating the "cost" of exempting such things as truck tires, text books, or nonprescription drugs cannot so easily be done. This should not be of particular concern unless the intent is to exempt more things than are included in the tax base.

The applicability of the estimates will depend on the effective date of the imposition of the tax. Two considerations are involved here. The first one is that an adjustment to the revenue estimates from calendar year to fiscal year, regardless of when the tax would go into effect, should be made. However, this adjustment will be different if the tax is imposed in the middle of a fiscal year as opposed to the beginning of a fiscal year. In either instance, seasonal variations in consumption patterns should be accounted for.

The second consideration, more important than the first, is that collections, regardless of the extent of the tax, will fall short of 100 percent of the revenue projections presented in this report. This is because some time will be required for the public as well as the administrating agency (Department of Revenue) to adjust to the new tax. The policy implication is that various goals (whatever they might be) of revenue allocation cannot be fully realized in the first year and probably not in the second year of the tax.

Common understanding is that a sales tax is a tax on household consumption. But sales taxes cover a wide variety of transactions, not only between consumers and "retailers" but between businesses as well. Depending on the structure of the tax, the initial incidence on business can be substantial. The problem is to determine the extent to which the tax is shifted and in which direction.

Some argue that a sales tax on business is automatically shifted forward to the consumer. If the sales tax were truly a single-stage tax in the distribution process, this might well be true. In fact, the tax may also be imposed on factors of production and at several other stages. It is here that the issue of tax shifting becomes murky and difficult to measure, and market structure can further compound the problem.

This report does not attempt to address this or other equally important issues: Is the sales tax really regressive, as opponents claim, or is it at worst proportional, as some proponents assert? Is current year income the sole criterion by which to assess the impact of the tax, or is some other concept of income better? Is the most efficient way to alleviate the perceived burden of the sales tax through exemption or tax credit? How can the tax structure be designed to minimize pyramiding and ensure revenue stability? What legal issues are involved? How should the revenue be spent?

If the 1989 Legislature seriously considers a sales tax, it will have to grapple with these issues and more.

It is the primary purpose of this report to provide a foundation (relative to potential revenue) upon which debate can securely be based.

END NOTES

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[3] Florida Department of Revenue, *Estimation of Potential Revenues*, pp. 8 and 10.

[4] U.S. Bureau of Census, *1982 Census of Service Industries*: *Montana*, (August 1984), p. A-2.

[5] Ghazanfar, S. M., "Equity Effects and Revenue Potential of Sales Taxation of Services: Some Empirical Findings," *Public Finance Quarterly*, 3:2 (April 1975), pp. 163-189.

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APPENDIX

The appendix contains the Senate version of House Bill No. 377 (1987). It includes only that portion which deals with the sales and use tax provisions of the bill (Sections 1 through 42).

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HOUSE BILL NO. 377

INTRODUCED BY RAMIREZ, FRITZ, CRIPPEN, HIRSCH

A BILL FOR AN ACT ENTITLED: "~~THE RETAIL SALES AND USE TAX ACT;~~ AN ACT ESTABLISHING A 4 PERCENT RETAIL SALES AND USE TAX; ~~PROVIDING A REDUCTION IN THE STATEWIDE MILL LEVIES FOR ELEMENTARY AND SECONDARY EDUCATION; PROVIDING FOR THE DISTRIBUTION OF THE REVENUE FROM THE SALES AND USE TAX;~~ GENERALLY REVISING THE CLASSIFICATION OF PROPERTY FOR PROPERTY TAX PURPOSES; EXEMPTING THE FIRST $20,000 OF MARKET VALUE OF SINGLE-FAMILY RESIDENCES FROM PROPERTY TAXATION; EXEMPTING LIVESTOCK, AGRICULTURAL PRODUCTS, AIRCRAFT, WATERCRAFT, ALL-TERRAIN VEHICLES, AND CERTAIN OTHER PROPERTY FROM PROPERTY TAXATION; PROVIDING A PER CAPITA FEE ON LIVESTOCK; REVISING LOCAL GOVERNMENT BONDING AND DEBT LIMITS; PROVIDING ~~A CREDIT~~ CREDITS AGAINST INDIVIDUAL INCOME TAX LIABILITY; PROVIDING THAT A PERSON COLLECTING THE SALES AND USE TAX BE ALLOWED TO RETAIN 1 PERCENT OF THE COLLECTIONS TO COVER THE COSTS OF COLLECTING THE TAX; AMENDING SECTIONS ~~15-18-185, 17-7-502,~~ 7-1-2111, 7-3-1321, 7-6-2211, 7-6-4121, 7-6-4254, 7-7-107, 7-7-108, 7-7-2101, 7-7-2203, 7-7-4201, 7-7-4202, 7-13-4103, 7-14-236, 7-14-2524, 7-14-2525, 7-14-4402, 7-16-2327, 7-16-4104, 7-31-106, 7-31-107, 7-34-2131, 15-1-101, 15-6-133 THROUGH 15-6-136, 15-6-147, 15-6-201, 15-6-207, 15-8-111, ~~15-8-202,~~

15-8-205, 15-8-301, 15-8-404, 15-8-405, 15-8-706, 15-16-611, 15-24-301, 15-24-302, 15-24-1102, 15-24-1103, 19-11-503, 19-11-504, 20-9-141, 20-9-331, 20-9-333, ~~AND 20-9-343,~~ 20-9-352, 20-9-406, 20-9-407, 20-9-501, 20-9-502, 20-10-144, 37-7-407, ~~61-3-431,~~ 61-3-501, ~~61-4-112, 61-18-231,~~ ~~61-12-206,~~ 67-3-201, 67-3-202, 81-6-101, 81-6-104, 81-6-204, 81-6-209, 81-7-103, 81-7-104, 81-7-201, 81-7-202, 81-7-303, 81-7-305, 81-8-804, AND 85-7-2001, MCA; REPEALING SECTIONS 15-6-137 THROUGH 15-6-140, 15-6-142, ~~THROUGH 15-6-144~~ ~~15-6-143~~ 15-6-144, 15-6-146, 15-24-304, 15-24-901 THROUGH 15-24-906, 15-24-908 THROUGH 15-24-911, 15-24-921 THROUGH 15-24-926, 15-24-931, 15-24-941 THROUGH 15-24-943, ~~61-3-502,~~ ~~61-3-605,~~ AND 81-7-118, MCA, AND INITIATIVE NO. 105; ~~PROVIDING THAT THE PROPOSED ACT BE SUBMITTED TO THE ELECTORS OF THE STATE OF MONTANA AT THE NOVEMBER 1988 GENERAL ELECTION;~~ PROVIDING THAT CERTAIN SECTIONS OF THIS ACT BE SUBMITTED TO THE ELECTORS OF THE STATE OF MONTANA; AND PROVIDING ~~A CONTINGENT~~ EFFECTIVE ~~DATE~~ DATES AND APPLICABILITY DATES."

WHEREAS, THE ELECTORS ENACTED INITIATIVE NO. 105, DIRECTING THE LEGISLATURE TO DEVELOP A TAX SYSTEM FAIR TO PROPERTY TAXPAYERS AND PROVIDE ADEQUATE FUNDING FOR LOCAL GOVERNMENT AND EDUCATION; AND

WHEREAS, THE SPONSORS OF INITIATIVE NO. 105 HAVE

INDICATED THAT THE TRUE PURPOSE OF INITIATIVE NO. 105 WAS TO URGE THE ENACTMENT OF A SALES TAX; AND

WHEREAS, THIS ACT REDUCES PROPERTY TAXES ON A STATEWIDE BASIS AND REPLACES PROPERTY TAX REVENUE LOST TO LOCAL GOVERNMENT AND EDUCATION WITH SALES TAX REVENUE; AND

WHEREAS, THIS ACT FULFILLS THE TRUE PURPOSE OF THE SPONSORS OF INITIATIVE NO. 105.

BE IT ENACTED BY THE LEGISLATURE OF THE STATE OF MONTANA:

(Refer to Introduced Bill)

Strike everything after the enacting clause and insert:

(Refer to Third Reading Bill)

Strike sections 1 through 42 in their entirety;

insert sections 1 through 66 as follows:

NEW SECTION. Section 1. Definitions. For purposes of [sections 1 through 67 and 78] unless the context requires otherwise, the following definitions apply:

(1) "Buying", "selling", "buy", "sell", or "sale" means the transfer of property for consideration or the performance of service for consideration.

(2) "Construction" means:

(a) the building, altering, repairing, or demolishing in the ordinary course of business of any:

(i) road, highway, bridge, parking area, or related project;

(ii) building, stadium, or other structure;

(iii) airport, subway, or similar facility;

(iv) park, trail, athletic field, golf course, or similar facility;

(v) dam, reservoir, canal, ditch, or similar facility;

(vi) sewage or water treatment facility, power generating plant, pump station, natural gas compressing station, gas processing plant, coal gasification plant, refinery, distillery, or similar facility;

(vii) sewage, water, gas, or other pipeline;

(viii) transmission line;

(ix) radio, television, or other tower;

(x) water, oil, or other storage tank;

(xi) shaft, tunnel, or other mining appurtenance; or

(xii) microwave station or similar facility;

(b) the leveling or clearing of land;

(c) the excavating of earth;

(d) the drilling of wells of any type, including seismograph shot holes or core drilling; or

(e) any similar work.

(3) "Department" means the department of revenue.

(4) "Engaging in business" means carrying on or causing to be carried on any activity with the purpose of direct or indirect benefit.

(5) "Food product for human consumption":

(a) means and includes:

(i) cereals and cereal products, margarine, meat and meat products, fish and fish products, eggs and egg products, vegetables and vegetable products, fruit and fruit products, spices, salt, sugar, sugar substitutes, sugar products other than candy and confectioneries, coffee and coffee substitutes, tea, and cocoa and cocoa products other than candy or confectioneries;

(ii) milk and cream and their products;

(iii) all fruit juices containing 15% or more real fruit juice, vegetable juices, and other beverages, except bottled water, spirituous, malt, or various other liquors, or carbonated beverages, whether liquid or frozen; and

(b) does not mean or include medicines or preparations, in liquid, powdered, granular, bottled, capsule, lozenge, or pill form, sold as a dietary supplement or adjunct not prescribed by a licensed physician.

(6) (a) "Gross receipts", in addition to the other meanings provided in this subsection (6), means the total amount of money or the value of other consideration received from selling property in Montana, from leasing property used in Montana, or from performing services in Montana. The term includes all receipts from the sale of tangible personal property handled on consignment but excludes cash discounts allowed and taken and any type of time-price differential.

(b) In an exchange in which the money or other consideration received does not represent the value of the property or service exchanged, gross receipts means the reasonable value of the property or service exchanged.

(c) (i) Except as provided in [section 53], when the sale of property or service is made under any type of charge or conditional or time-sales contract or the leasing of property is made under a leasing contract, the seller or lessor shall treat all receipts, excluding any type of time-price differential, under such contracts as gross receipts at the time of the sale.

(ii) If the seller or lessor transfers his interest in any such contract to a third person, the seller or lessor shall pay the sales tax or use tax upon the full sale or leasing contract amount, excluding any type of time-price differential.

(d) Gross receipts includes all amounts paid by members of any cooperative association or similar organization for sales or leases of personal property or performance of services by such organization.

(7) "Lease" or "leasing" means an arrangement in which, for a consideration, property is used for or by a person other than the owner of the property.

(8) "Manufacturing" means combining or processing components or materials to increase their value for sale in

the ordinary course of business. The term does not include construction.

(9) "Medical services" means a service performed by a person licensed to practice medicine, osteopathy, dentistry, podiatry, optometry, chiropractic, or psychology as a regular part of his business activities and applied externally or internally to the human body or mind for the diagnosis, cure, mitigation, treatment, or prevention of disease.

(10) "Medicine" or "drug" means and includes any substance or preparation intended for use by external or internal application to the human body or mind in the diagnosis, cure, mitigation, treatment, or prevention of disease, which substance or preparation is required by law or regulation to be prescribed by a person licensed to prescribe such drug or medicine.

(11) "Permit" means a seller's permit as described in [section 44].

(12) "Person" means:

(a) an individual, estate, trust, receiver, cooperative association, club, corporation, company, firm, partnership, joint venture, syndicate, or other entity, including any gas, water, or electric utility owned or operated by a county, municipality, or other political subdivision of the state; or

(b) the United States or any agency or instrumentality of the United States or the state of Montana or any political subdivision of the state.

(13) "Sales tax" and "use tax" mean the applicable tax imposed by [section 2].

(14) (a) "Service" means any activity engaged in for another person for a consideration, which activity involves the performance of a service as distinguished from the sale or lease of property. The term includes activities performed by a person for its members or shareholders and construction activities and all tangible personal property that will become an ingredient or component part of a construction project.

(b) In determining what a service is, the intended use, principal objective, or ultimate objective of the contracting parties is irrelevant.

(15) "Therapeutic and prosthetic devices" includes but is not limited to prescription eyeglasses, contact lenses, dentures, and artificial limbs, prescribed or ordered by a person licensed to practice medicine, osteopathy, dentistry, podiatry, optometry, or chiropractic.

(16) "Use" or "using" includes use, consumption, or storage other than storage for subsequent sale, in the ordinary course of business, or for use solely outside this state.

NEW SECTION. Section 2. Imposition and rate of sales tax and use tax. (1) Except as provided in subsection (5), a sales tax of ~~5%~~ 4% is imposed on all gross receipts, as defined in [section 1], for the privilege of engaging in business in this state.

(2) For the privilege of using property in this state, there is imposed on the person using the property a use tax equal to ~~5%~~ 4% of the value of the property that was:

(a) manufactured by the person using the property in this state;

(b) acquired outside this state as the result of a transaction that would have been subject to the sales tax had it occurred within this state; or

(c) acquired as the result of a transaction that was not initially subject to the use tax imposed by subsection (2)(b) or the sales tax imposed by subsection (1) but which transaction, because of the buyer's subsequent use of the property, is subject to the sales tax or use tax.

(3) For the privilege of using services rendered in this state, there is imposed on the person using such services a use tax equal to ~~5%~~ 4% of the value of the services at the time at which they were rendered. Services taxable under this section must have been rendered as the result of a transaction that was not initially subject to the sales tax or use tax but which transaction, because of the buyer's subsequent use of the service, is subject to the sales tax or use tax.

(4) For purposes of this section, the value of property must be determined as of the time of acquisition, introduction into this state, or conversion to use, whichever is later.

(5) A sales tax of ~~3-1/2%~~ 2 1/2% is imposed on the gross receipts from the sale of any new motor vehicle subject to the provisions of 61-3-502.

NEW SECTION. Section 3. Presumption of taxability -- value. (1) In order to prevent evasion of the sales tax or use tax and to aid in its administration, it is presumed that:

(a) all receipts of a person engaging in business are subject to the sales tax or use tax; and

(b) all property bought or sold by any person for delivery into this state is bought or sold for a taxable use in this state.

(2) In determining the amount of tax due on the use of property or services, it is presumed, in the absence of preponderant evidence of another value, that value means the total amount of property or the reasonable value of other consideration paid for the use of the property or service, exclusive of any type of tax-price differential. However, in an exchange in which the amount of money paid does not

represent the value of the property or service purchased, the use tax must be imposed on the reasonable value of the property or service purchased.

NEW SECTION. Section 4. Separate statement of tax. (1) If the sales tax or use tax is stated separately on the books of the seller or lessor and the total amount of tax stated separately on transactions reportable within the reporting period is in excess of the amount of sales tax or use tax otherwise payable on those transactions, the excess amount of tax otherwise payable and stated on the transactions within the reporting period must be included in gross receipts.

(2) If the sales tax or use tax is not stated separately on transactions, the gross receipts for sales tax and use tax purposes include the total amounts received, with no deduction for the sales tax or use tax.

NEW SECTION. Section 5. Liability of user for payment of use tax. (1) A person in this state who uses property is liable to the state for payment of the use tax if the tax is payable on the value of the property but has not been paid.

(2) The liability imposed by this section is discharged if the buyer has paid the use tax to the seller for payment to the department.

NEW SECTION. Section 6. Agents for collection of sales tax and use tax. (1) (a) A person who performs or

attempts to perform an activity within this state that attempts to exploit this state's markets, who sells property or services for use in this state, and who is not subject to the sales tax or use tax on receipts from these sales shall collect the sales tax or use tax from the buyer and pay the tax collected to the department.

(b) "Activity", for the purposes of this section, includes but is not limited to engaging in any of the following in this state:

(i) maintaining an office or other place of business that solicits orders through employees or independent contractors;

(ii) canvassing;

(iii) demonstrating;

(iv) collecting money;

(v) warehousing or storing merchandise; or

(vi) delivering or distributing products as a consequence of an advertising or other sales program directed at potential customers.

(2) To ensure orderly and efficient collection of the tax imposed by [sections 1 through 67 and 78], if any application of this section is held invalid, the section's application to other situations or persons is not affected.

NEW SECTION. Section 7. Nontaxable transaction certificate. (1) A nontaxable transaction certificate executed by a buyer or lessee must be in the possession of the seller or lessor at the time a nontaxable transaction occurs.

(2) If the seller or lessor is not in possession of a nontaxable transaction certificate within 60 days from the date notice of the requirement for possession of a nontaxable transaction certificate is given to him by the department, all deductions claimed by him that require delivery of a nontaxable transaction certificate are disallowed.

(3) A nontaxable transaction certificate must contain the information and be in the form prescribed by the department.

(4) Only a buyer or lessee who has registered with the department and whose permit is not suspended or revoked may be allowed to execute a nontaxable transaction certificate.

(5) If the seller or lessor accepts a nontaxable transaction certificate within the required time and believes in good faith that the buyer or lessee will employ the property or service transferred in a nontaxable manner, the properly executed nontaxable transaction certificate is considered conclusive evidence that the proceeds from the transaction are deductible from the seller's or lessor's gross receipts.

NEW SECTION. Section 8. Government agencies and

utilities exempt. (1) All receipts of the United States or any agency or instrumentality of the United States or of this state or any political subdivision of this state are exempted from the sales tax and use tax.

(2) All receipts from the sale of gas, water, or electricity, and ANY fuel or energy used to produce heating, cooling, or lighting, and telephone service, including long-distance charges and access charges, are exempt from the sales TAX and use tax.

NEW SECTION. Section 9. Exemption -- food products. (1) Except as provided in subsection (2), receipts from sales of food products for human consumption are exempt from the sales tax.

(2) The gross receipts from food products sold in the following manner are not exempt from the sales tax:

(a) any food products served as meals on or off the premises of the retailer;

(b) milk or cream sold as beverages commonly referred to as milk shakes, malted milks, or any similar beverage;

(c) food products furnished, prepared, or served for consumption at tables, chairs, or counters or from trays, glasses, dishes, or other tableware, whether provided by the retailer or by a person with whom the retailer contracts to furnish, prepare, or serve food products to others;

(d) food products sold for immediate consumption on or near a location at which parking facilities are provided primarily for the ease of patrons in consuming the products purchased at the location, even though such products are sold on a "take out", "to go", or "U-bake" order and are actually packaged or wrapped and taken from the premises of the retailer; or

(e) food products sold for consumption within a place that charges an admission fee.

NEW SECTION. Section 10. Exemption -- medicines, drugs, and medical services. (1) The gross receipts from the sale of medicines, drugs, and therapeutic and prosthetic devices are exempt from the sales tax.

(2) The gross receipts from the sale of medical services are exempt from the sales tax.

NEW SECTION. Section 11. Exemption -- wages. The receipts of an employee from an employer for wages, salary, commissions, or any other form of remuneration for personal services are exempt from the sales tax.

NEW SECTION. Section 12. Exemption -- agricultural products. The receipts of a grower, producer, trapper, or nonprofit marketing association from the sale of livestock, live poultry, unprocessed agricultural products, hides, or pelts are exempt from the sales tax. Persons engaged in the business of buying and selling wool or mohair or of buying and selling livestock on their own account and without the

services of a broker, auctioneer, or other agent are considered producers for the purposes of this section.

NEW SECTION. Section 13. Exemption -- livestock feeding. A person's receipts derived from feeding, pasturing, penning, or handling or the training of livestock prior to sale are exempt from the sales tax.

NEW SECTION. Section 14. Exemption -- vehicles. The receipts from the sale of any vehicle upon which a tax pursuant to [sections 1 through 67 and 78] has been paid or which was purchased prior to [the applicability date of this act] are exempt from the sales tax. A registration certificate showing that the vehicle was registered in this state prior to [the applicability date of this act] is conclusive proof that it was purchased on or before it was subject to taxation under [sections 1 through 67 and 78] and is exempt under this section.

NEW SECTION. Section 15. Exemption -- insurance companies. The receipts of an insurance company or any of its agents from premiums are exempt from the sales tax.

NEW SECTION. Section 16. Exemption -- dividends and interest. The receipts of interest on money loaned or deposited or dividends or interest from stocks, bonds, or securities or from the sale of stocks, bonds, or securities are exempt from the sales tax.

NEW SECTION. Section 17. Exemption -- fuel. The receipts from the sale of gasoline, ethanol blended for fuel, or special fuel on which the Montana gasoline and special fuels tax has been paid under Title 15, chapter 70, are exempt from the sales tax and use tax.

NEW SECTION. Section 18. Exemption -- isolated or occasional sale or lease of property or services. The receipts from the isolated or occasional sale or lease of property or performance of a service by a person who is not regularly engaged in or who does not represent himself as engaged in the business of selling or leasing the same or a similar property or service are exempt from the sales tax.

NEW SECTION. Section 19. Exemption -- oil, gas, and mineral interests. The receipts from the sale or lease of oil, natural gas, or mineral interests are exempt from the sales tax.

NEW SECTION. Section 20. Exemption -- minerals. The receipts from the sale or use of a mineral as defined in 15-38-103 are exempt from the sales tax and use tax. Minerals refined, reduced, polished, cut, faceted, or otherwise processed for the purpose of being used as or integrated into jewelry, art, or sculpture~~,~~ or as a decorative embellishment or adornment in their own right or to other property are not included in the exemption provided in this section.

NEW SECTION. Section 21. Exemption -- governmental

agencies. (1) The use of property by the United States or any agency or instrumentality of the United States or by this state or any political subdivision of this state is exempt from the use tax.

(2) The use of property by the governing body of an Indian tribe on a federally recognized Indian reservation is exempt from the use tax.

NEW SECTION. Section 22. Exemption -- personal effects. The use by an individual of personal or household effects brought into the state for the establishment by him of an initial residence in this state and the use of property brought into the state by a nonresident for his own nonbusiness use while temporarily within this state are exempt from the use tax.

NEW SECTION. Section 23. Exemption -- advertising services. The gross receipts from the sale of advertising services, including the actual creation or development of the advertising, are exempt from the sales tax. For the purpose of this section, "advertising ~~service~~ SERVICES" includes but is not limited to all advertising in or by:

~~(a)~~(1) any newspaper, magazine, or other publication;

~~(b)~~(2) radio or television;

~~(c)~~(3) billboard, banner, sign, placard, and the like;

~~(d)~~(4) handbill; or

~~(e)~~(5) any other advertising means, media, or method.

NEW SECTION. Section 24. Deduction -- sale of tangible personal property for resale. Receipts from the sale of tangible personal property may be deducted from gross receipts if:

(1) the sale is made to a buyer who delivers a nontaxable transaction certificate to the seller; and

(2) the buyer resells or plans to resell the tangible personal property either by itself or in combination with other tangible personal property in the ordinary course of business and the property will subsequently be subject to the sales tax.

NEW SECTION. Section 25. Deduction -- sale of service for resale. Receipts from the sale of a service for resale may be deducted from gross receipts if:

(1) the sale is made to a person who delivers a nontaxable transaction certificate;

(2) the buyer separately states the value of the service purchased in his charge for the service on its subsequent sale; and

(3) the subsequent sale is in the ordinary course of business and subject to the use tax.

NEW SECTION. Section 26. Deduction -- sale to manufacturer. Receipts from the sale of tangible personal property to a buyer engaged in the business of manufacturing may be deducted from gross receipts if:

(1) the buyer delivers a nontaxable transaction certificate to the seller; and

(2) the buyer incorporates or will incorporate the tangible personal property as an ingredient or component part of the product which he is in the business of manufacturing.

NEW SECTION. Section 27. Deduction -- sale of tangible personal property for leasing. Receipts from the sale of tangible personal property, other than furniture or appliances, and from the rental or lease of property, other than coin-operated machines and mobile homes, that is deductible under [sections 1 through 67 and 78] may be deducted from gross receipts if:

(1) the sale is made to a buyer who delivers a nontaxable transaction certificate to the seller;

(2) the buyer is engaged in a business deriving more than 50% of its receipts from leasing or selling tangible personal property of the type leased; and

(3) the buyer does not use the property in any manner other than holding it for lease or sale or leasing or selling it, either by itself or in combination with other tangible personal property, in the ordinary course of business.

NEW SECTION. Section 28. Deduction -- lease for subsequent lease. Receipts from the lease of tangible personal property, other than furniture or appliances, and from the rental or lease of property, other than coin-operated machines and mobile homes, that is deductible under [sections 1 through 67 and 78] may be deducted from gross receipts if:

(1) the lease is made to a lessee who delivers a nontaxable transaction certificate; and

(2) the lessee does not use the property in any manner other than for subsequent lease in the ordinary course of business.

NEW SECTION. Section 29. Deduction -- sale of tangible personal property to person engaged in construction business. (1) Receipts from the sale of tangible personal property may be deducted from gross receipts if the sale is made to a buyer engaged in the construction business who delivers a nontaxable transaction certificate to the seller.

(2) Receipts from the sale may be deducted if the buyer incorporates the tangible personal property as:

(a) an ingredient or component part of a construction project that is subject to the sales tax or use tax upon its completion or upon the completion of the overall construction project of which it is a part; or

(b) an ingredient or component part of a construction project that is subject to the sales tax or use tax upon the sale in the ordinary course of business of the real property

upon which it was constructed.

NEW SECTION. Section 30. Deduction -- machinery and equipment used in trade or business. (1) The receipts from the sale or use of machinery or equipment used in a trade or business may be deducted from gross receipts if the buyer:

(a) delivers a nontaxable transaction certificate to the seller; or

(b) brings the machinery and equipment into this state for use in a trade or business.

(2) Receipts from the sale or use of machinery or equipment may be deducted if the buyer uses the property as equipment or machinery in his business. For purposes of this section, "equipment and machinery" means tangible personal property that will not be consumed in or made a part of any product or service.

NEW SECTION. Section 31. Deduction -- sale of construction service to person engaged in construction business. (1) Receipts from the sale of a construction service may be deducted from gross receipts if the sale is made to a buyer engaged in the construction business and he delivers a nontaxable transaction certificate to the person performing the construction service.

(2) Receipts from the service may be deducted if the buyer has the construction services performed upon:

(a) a construction project that is subject to the sales tax or use tax upon its completion or upon the completion of the overall construction project of which it is a part; or

(b) a construction project that is subject to the sales tax or use tax upon the sale in the ordinary course of business of the real property upon which it was constructed.

NEW SECTION. Section 32. Deduction -- sale or lease of real property and lease of mobile homes. (1) (a) Receipts from the sale or lease of real property except as provided in subsection (b), from the lease of a mobile home, or from the rental of a mobile home for a period of at least 1 month may be deducted from gross receipts.

(b) The portion of the gross receipts from the sale of real property that is attributable to improvements constructed on the real property by the seller in the ordinary course of his construction business may not be deducted from gross receipts.

(2) Receipts attributable to the inclusion of furniture or appliances furnished by the landlord or lessor as part of a leased or rented dwelling, house, mobile home, cabin, condominium, or apartment may be deducted from gross receipts.

(3) Receipts received by hotels, motels, roominghouses, campgrounds, guest ranches, trailer parks, or similar facilities are not receipts from leasing real

property for purposes of this section if such receipts are taxable under a lodging or accommodation type tax on either the operator or the user.

NEW SECTION. Section 33. Deduction -- transaction in interstate commerce. (1) Receipts from a transaction in interstate commerce may be deducted from gross receipts to the extent that the imposition of the sales tax or use tax would be unlawful under the United States constitution.

(2) (a) Receipts from transmitting messages or conversations by radio, if originated from a point outside this state to another point within this state, and receipts from the sale of radio or television broadcast time if the advertising message is supplied by or on behalf of a national or regional seller or an advertiser not having its principal place of business in or being incorporated under the laws of this state may be deducted from gross receipts.

(b) Commissions received by an advertising agency for performing services in this state may not be deducted from gross receipts under this section.

NEW SECTION. Section 34. Deduction -- intrastate transportation and services ~~in--interstate--commerce.~~ ~~(1)~~ Receipts from the transport of persons or property from one point within this state to another point within this state may be deducted from gross receipts ~~if-such-persons-or property,-including-any-reasonably-necessary--services,--are~~

~~being transported in interstate or foreign commerce under a single contract.~~

~~(2) Receipts from handling, storage, drayage, or packing of property or any other accessorial services on property may be deducted from gross receipts if:~~

~~(a) the property has been or will be moved in interstate or foreign commerce;~~

~~(b) the services are performed by a local agent for a carrier or by a carrier; and~~

~~(c) the services are performed under a single contract in relation to transportation services.~~

NEW SECTION. Section 35. Deduction -- sale of certain services to out-of-state buyer. (1) Receipts from performing a service, other than a legal or accounting service, may be deducted from gross receipts if the sale of the service is made to a buyer who delivers to the seller either a nontaxable transaction certificate or other evidence acceptable to the department that the transaction meets the conditions set out in subsection (3).

(2) The person who delivers the nontaxable transaction certificate or other evidence acceptable to the department must meet the conditions set out in subsection (3).

(3) Receipts from the performance of a service are subject to the deduction provided in this section if the buyer of the service, any of his employees, or any person in

privity with him:

(a) does not make initial use of the product or the service in this state;

(b) does not take delivery of the product or the service in this state; or

(c) concurrent with the performance of the service, does not have a regular place of work in this state or spend more than brief and occasional periods of time in this state and:

(i) does not have any communication in this state related in any way to the subject matter, performance, or administration of the service with the person performing the service; or

(ii) does not himself perform work in this state related to the subject matter of the service.

(4) Receipts from performing a service that initially qualified for the deduction provided in this section but which no longer meets the criteria set forth in subsection (3) is deductible for the period prior to the disqualification.

NEW SECTION. Section 36. Deduction -- feed, fertilizers, and agricultural supplies -- livestock auctioneers. (1) Receipts from the sale of feed for livestock, fish raised for human consumption, poultry, animals raised for their hides or pelts, semen used in animal husbandry, seeds, roots, bulbs, soil conditioners, fertilizers, insecticides, insects used to control the population of other insects, fungicides, weedicides, herbicides, or water for irrigation purposes may be deducted from gross receipts if the sale is made to a person who states in writing that he is regularly engaged in the business of farming, ranching, or the raising of animals for their hides or pelts.

(2) Receipts of auctioneers from selling livestock or other agricultural products at auction may be deducted from gross receipts.

NEW SECTION. Section 37. Deduction -- certain chemicals and reagents. (1) Receipts from the sale of chemicals or reagents to any mining concern or milling company for use in processing ores or oil in a mill, smelter, or refinery or in acidizing oil wells and receipts from the sale of chemicals or reagents in an amount in excess of 18 tons may be deducted from gross receipts.

(2) Receipts from the sale of explosives, blasting material, or dynamite may not be deducted from gross receipts.

NEW SECTION. Section 38. Deduction -- trade-in allowance. That portion of the receipts of a seller that is represented by a trade-in of tangible personal property of the same type as the property being sold may be deducted

from gross receipts.

NEW SECTION. Section 39. Deduction -- special fuel. (1) Receipts from the sale of special fuel, as defined in 15-70-301, may be deducted from gross receipts if the purchaser uses the special fuel in agriculture, or to operate machinery, equipment, or vehicles used in a trade or business.

(2) Receipts from the sale of special fuel used to heat buildings for human comfort are not deductible.

NEW SECTION. Section 40. Deduction -- sale of certain services performed directly on product manufactured. Receipts from sale of the service of combining or processing components or materials may be deducted from gross receipts if the sale is made to a buyer who is engaged in the business of manufacturing and delivers a nontaxable transaction certificate to the seller. The receipts from the service may be deducted if the buyer has the service performed directly upon tangible personal property that he is in the business of manufacturing or upon ingredients or component parts of such property.

NEW SECTION. Section 41. Deduction -- certain mobile homes. Receipts from the resale of a mobile home may be deducted from gross receipts if the sale is of a mobile home that was subject to the sales tax or use tax upon its initial sale or use in this state or was initially sold or used in this state prior to [the applicability date of this act]. The receipts from the resale may be deducted if the seller retains and furnishes proof satisfactory to the department that the sales tax or use tax was paid upon the initial sale or use in this state of the mobile home. In the absence of such proof, it is presumed that the tax was not paid. Proof that a Montana certificate of title was issued for a mobile home prior to [the applicability date of this act] is proof that the mobile home was initially sold or used in this state prior to [the applicability date of this act] and exempt under this section.

NEW SECTION. Section 42. Deduction -- use of tangible personal property for leasing. (1) Except as provided in subsection (2), the value of leased property may be deducted in computing the use tax due if the person holding the tangible personal property for lease:

(a) is engaged in a business that derives a substantial portion of its receipts from leasing or selling property of the type leased;

(b) does not use the property in any manner other than holding it for lease or sale or leasing or selling it either by itself or in combination with other tangible personal property in the ordinary course of business; and

(c) does not use the property in a manner incidental to the performance of a service.

(2) The deduction provided in subsection (1) does not apply to the value of furniture or appliances furnished by the landlord or lessor as part of a leased or rented dwelling, house, cabin, condominium, or apartment or to the lease of coin-operated machines or mobile homes.

NEW SECTION. Section 43. Credit -- out-of-state taxes. (1) If a gross receipts, sales, use, or similar tax has been levied by another state or a political subdivision of another state on property bought outside this state but which will be used or consumed in this state and the tax was paid, the amount of tax paid may be credited against any use tax due this state on the same property.

(2) If the receipts from the sale of improvements to real property constructed by a person in the ordinary course of his construction business are subject to the sales tax or use tax, the amount of tax paid by the person under subsection (1) on materials that became an ingredient or component part of the construction project and on construction services performed upon the construction project may be credited against the sales tax or use tax due on the sale.

NEW SECTION. Section 44. Seller's permit. Upon an applicant's compliance with [sections 1 through 67 and 78], the department shall issue to the applicant a separate, numbered seller's permit for each place of business within

THE GREAT SEAL OF THE STATE OF MONTANA
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